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**Durham University**

**The Impact of Government Policies on Foreign Direct  
Investment in Developing Countries: the Case of Sudan**

**By**

**Mohamed Nour Mohamed Osman Abdalla**

**Thesis Submitted in Fulfilment of the Degree of Doctor of Philosophy at Durham  
University**

**The School of Government and International Affairs**

**Institute of Middle Eastern and Islamic Studies**

**University of Durham, UK**

**2014**

## **Abstract**

Currently, policies implemented by governments in developing countries are dominated by the view that Foreign Direct Investment (FDI) is necessary for development and that, without FDI, there would be no growth. They also believe that FDI brings efficient management of resources, new technology, a culture of competition, and access to global markets. FDI is considered the best source of development finance on the grounds, among others, that it is self-liquidating. Obviously, Sudan is not an exception, with policies of economic liberalisation, policies of economic restructuring, attention to the infrastructure, privatisation, and establishment of the capital market, and other measures to attract FDI.

The aim of this research is to explore the impact of policies followed by the host country on the amount of inward FDI and the impact of FDI on the economic development of the host country. It is important to focus on the theoretical foundation of the FDI phenomenon and its relevance in explaining FDI determinants.

In conducting this research, a combination of qualitative and quantitative methods have been employed. A case study approach has been adopted to investigate the impact of the measures taken by the government of Sudan to encourage FDI. As well as investigating the impact at the macroeconomic level, the study focuses on the three sectors most affected by FDI: oil, real estate and telecommunications.

Oil production and exports are of vital importance for Sudan's economy, and hence the government has focused much of its effort on this sector, which is dominated by Chinese companies. Many of the issues faced were similar to those experienced elsewhere in Africa where China is the source of FDI. The inflows to the real estate sector were mainly from the Gulf, with developers seeking to build residential accommodation and commercial property which would appeal to Sudanese expatriates returning from work there. Telecommunications, in particular mobile services, have brought about a social revolution in Sudan, as well as elsewhere in Africa. The government's aim was to open the market up, with competition making phone tariffs more affordable. Overall, government policies to encourage FDI have been successful but it is evident that different policies are needed for each sector.

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## **List of Abbreviations**

APCO - Advanced Petroleum Operating Company

ASEAN – Association of South East Asian Nations

CNPC – China National Petroleum Company

CNS – Comprehensive National Strategy

COMESA – Common Market of East and Southern Africa Countries

DFID – United Kingdom Department for International Development

ECLAC – Economic Commission for Latin America

EU – European Union

FDI – Foreign Direct Investment

GATT – General Agreement on Tariffs and Trade

GATT/UR – GATT Uruguay Round

GDI – Gross Domestic Income

GDP – Gross Domestic Product

GMI – Gross Mixed Income

GNP - Gross National Product

GNPOC – Greater Nile Petroleum Operating Company

GOS – Gross of Operating Surplus

IGAD – Intergovernmental Authority on Development

IMF – International Monetary Fund

IPR – Intellectual Property Rights



KRC - Khartoum Refinery Company

LDC – Lesser Developed Countries

MERCOSUR – Southern Cone Common Market

MFN – Most Favoured Nations

MIGA – World Bank’s Multinational Investment Guarantee Agency

MNC – Multinational Company

NAFTA – North America Free Trade Area

NTC – National Telecommunications Corporation

OECD – Organization for Economic Co-operation and Development

ONGC - Oil and Natural Gas Corporation

PDOC - Petrodar Petroleum Operating Company

PPP - Purchasing Power Parity

R&D – Research and Development

RSPOC - Red Sea Petroleum Operating Company

SDG – Sudanese Pound

SME – Small to Medium sized Enterprises

SNWA - Sudanese Nationals Working Abroad

SOE – State Owned Enterprises

SPLA - Sudan People’s Liberation Army

SSA – Sub-Saharan Africa

STPC – State-owned Telecommunications Public Corporation

TNC – Transnational Corporation

TRIMs – Trade Related Investment Measures

TRIPs – Trade Related Aspects of Intellectual Property Rights

UAE – United Arab Emirates

UN – United Nations

UNCTAD – United Nations Conference on Trade and Development

US – United States of America

WNPOC – White Nile Operating Company

WTO – World Trade Organization

## **Declaration**

I hereby declare that no portion of the work that appears in this study has been used in support of an application of another degree in qualification to this or any other university or institution.

This thesis is the result of my own work. Material from the published or unpublished work of others which is used in the thesis is credited to the author in question in the text.

## **Dedication**

**To those who showed me the meaning of encouragement and love:**

**My father, my mother,**

**My beloved wife, my lovely sons and daughter,**

**And my teachers.**

## **Acknowledgement**

All praises and thanks are for Allah, Most Gracious, and Most Merciful. I would like to express my greatest gratitude and deepest appreciation to my supervisors Professor Rodney Wilson and Dr Habib Ahmed, for their guidance, patience and constructive advice and support throughout my study at Durham University. Also I would like to extend my gratitude to Dr Ruth Wittlinger for her encouragement and supporting me in all the time of research and writing of this thesis.

I am grateful to the respondents for their cooperation in answering the questionnaire and interviews for study, especially those officials and key personnel in the Ministry of Foreign Trade and Central Bank of Sudan.

I would like to express my thanks to all my colleagues and to all academic staff and administrative staff in the School of Government and International Affairs, Durham University.

# **Chapter 1**

## **INTRODUCTION**

### **1.1 BACKGROUND**

Governments in developing countries are increasingly looking for best practice policies regarding Foreign Direct Investment (FDI). Renewed confidence in the positive benefits of FDI has led many countries that were restricting FDI in the 1960s, 1970s and 1980s to be more open towards FDI in the 1990s and beyond. Governments are liberalising FDI regimes as they associate FDI with positive effects on economic development and poverty reduction in their countries. Increased liberalisation and technological advances have led to a rapid growth in FDI flows over the last three decades and FDI has gained in its share of domestic investment and Gross Domestic Product (GDP) in many countries.

Over the past decades, many economies have dramatically reduced barriers to FDI, and countries at all levels of development have created a policy infrastructure to attract multinational firms (Baliga, 1994). Standard tactics to promote FDI include the extension of tax holidays, exemption from import duties, and the offer of direct subsidies. Since 1998, 103 countries have offered special tax concessions to foreign companies that have set up production or administrative facilities within their borders (Mathews, 2006). Typically, these concessions are applied to multinational enterprise but not to local firms in the same line of activity.

As many governments recognise the importance of attracting FDI, Sudan has created a policy to attract multinational firms. Since the early 1990s, Sudan has adopted and implemented liberal economic policy reforms. The main objective of the new policies is to liberalise the economy to enable economic activities to be mainly determined by market forces (Hamdi, 2002). Consequently, prices have been liberalised, and import/exports restrictions have been abolished, except for few commodities for religious and environmental considerations. Moreover, a more liberal law encouraging investment has been promulgated, an extensive privatisation and restructuring programme for public enterprise has been implemented, and the multiple and over-evaluated exchange rate has been replaced by a floating rate. In its endeavour to

liberalise trade, the government has taken numerous measures, including the removal of quantitative restrictions on imports and simplifying tariff procedures and structures.

As a result of these policies, economic performance has improved in real terms. Exports have increased, as well as being diversified (World Bank, 2009). In addition, the private sector has started to play a more active role in economic activities. Large private capital inflows, including FDI and exports of oil also increased and, like many governments which have created policies and succeeded in attracting FDI flows, FDI plays a key role in the economic activities and benefits for the Sudanese economy.

## **1.2 AIMS AND OBJECTIVES OF THE RESEARCH AND RESEARCH QUESTIONS**

The aims of this research are to investigate the possibility that the trade policy regime followed by the host country significantly influences the amount of inward FDI received by recipient country, to study the impact of FDI on the economic wellbeing of the recipient country, and to examine whether policies to promote FDI will raise the standards of the host country's economic wellbeing. It is important to discuss best practice policies to make openness work for development and the role of policies towards FDI. In addition, the research examines whether certain best practices and policies are emerging. More specifically to identify aims, the following objectives are developed:

1. To focus on the theoretical foundation of FDI phenomenon and its relevance in explaining FDI determinants.
2. To explore the impact of policies followed by the government of Sudan on the amount of inward FDI.
3. To examine the impact of FDI inflows on the economic growth of Sudan.
4. To discuss the importance, growth, structure, trend and distribution of FDI to Sudan.
5. To examine the impact of Chinese investment in Sudan in terms of its positive and negative effects.

6. To investigate the impact of FDI at the macroeconomic level, the study focuses on the three sectors most affected by FDI: oil, real estate and telecommunications.

This study focuses on the importance of the policies followed by the host country to the amount of inward FDI and the impact of FDI on the economic development of the host country. In order to fulfil the aim, the study will address the following questions:

1. To what extent has the economic literature provided an explanation of the FDI phenomenon and the main FDI characteristics?
2. What are the main factors influencing foreign investors' destinations?
3. What are the measures taken by the government of Sudan to encourage FDI?
4. Has there been any significant growth in the amount of FDI to Sudan according to the influence of public policies on inward FDI flows?
5. How does FDI in Sudan, from Western Europe as well as the United States, compare with that from countries of South East Asia such as China, Malaysia and Indonesia?
6. What are the impacts of FDI from China on economic development in Sudan?
7. What are the impacts of FDI on foreign trade as measured by the volume and structure of exports, and has FDI made any significant contribution to GDP in Sudan?
8. How have the telecommunications, oil production and real estate sectors benefiting most from FDI inflows to Sudan.
9. Has FDI improved Sudan's relationship with external regional and international financial institutions?

### **1.3 SIGNIFICANCE OF THE RESEARCH**

This research aims to investigate the policies followed by the host country, and the influences of these policies on the amount of inward FDI, and to examine the impact of FDI on economic growth of the host country. Sudan is not an exception with policies of economic liberalisation, policies of economic restriction, attention to the



infrastructure, privatisation, and establishment of the capital market and other measures to attract FDI. Thus, this study is focused on the measures taken by the government of Sudan to attract FDI.

There have been many in-depth empirical studies related to international trade and FDI, especially studies on the importance of FDI, and its relation to development (Hamdi, 2002). However, to date, there has been no academic study or research focusing on the impact of the Sudanese government policies on the FDI, specifically its relation to policies and economic reforms. As government has strong indigenous factors that encourage foreign firms to invest in Sudan, this study is conducted to analyse such impacts.

The present study is the first effort to investigate Sudanese government policies regarding FDI. It is also the first academic effort to examine the impact of Chinese investment in Sudan in terms of its positive and negative effects. Furthermore, it is hoped that it will inspire future research in relation to the issue of FDI, especially with regard to Sudan.

Therefore, this study is expected to contribute significantly to this field through its empirical work but also through providing an understanding to the Sudanese government and to strengthen policies and to identify issues related to FDI. Academically, this study also provides a different approach to assessing the measures taken by the government by examining foreign investor views and experiences in doing business in Sudan, through primary data.

#### **1.4 RESEARCH METHODOLOGY**

The present study could be described as being historical, descriptive and analytical. It is limited to period of 20 years, 1990 to 2010. Therefore, all data information and documents are related to the above period. In conducting this research, combinations of qualitative and quantitative methods have been employed here. Therefore, in order to examine their perceptions, questionnaire and interview survey approaches were used. These surveys were conducted with the objective of collecting primary data to be analysed for inferences. These approaches are vital for this research to support and substantiate, and hence validate, the findings from the revealed comparative analysis.

Details on the research methodology and approaches carried out are discussed in Chapter 5, the methodology chapter.

The bulk of the information and data dealing with the topic of this study was obtained through direct meetings and personal interviews with officials of the Sudanese Ministry of Foreign Trade, the Ministry of Foreign Affairs and the Ministry of Investment. In addition to this, the researcher has in his possession a wide range of specific information and data related to this topic of study, which has been collected by him through his working for the Ministry of Foreign Trade and his participation in a number of conferences and events of the World Trade Organization (WTO) held in Seattle, Brussels, Doha, Geneva and Cairo. Finally, secondary information and data related to the topic of the study was derived from reference books, workshop papers, documents, periodicals and reports.

In accordance with the aim of the research study and the critical issues raised above, the study adopts a mixed deductive and inductive approach in analysing the phenomenon under investigation by critically reviewing both economic literature and empirical evidence.

At the outset, the study reviews different economic theories relating to international trade and firm behaviour with the purpose of investigating their relevance and significance in explaining the FDI phenomenon. Factors influencing motives and behavioural pattern of Transnational Corporations (TNCs) are highlighted, being the most important vehicle of FDI.

In assessing the relevance of economic theories, the supporting vehicle of FDI is provided through the examination of illustrative examples of developing countries that have been successful in attracting FDI.

In order to examine the reliability of the study conclusions, recent international developments are investigated with a special focus on their potential implications on FDI, for both home and host countries.

## **1.5 ORGANISATION OF THE THESIS**

The thesis consists of 12 chapters, three of which (Chapters Two, Three and Four), relate to the theoretical foundation and background of the study. Chapters Six, Seven, Eight, Nine, Ten and Eleven are devoted to empirical study. Chapter Twelve presents the conclusions and recommendations.

The first chapter of the research includes an introduction to the topic, a detailed study description and the methodology of the study.

Chapter Two is mainly concerned with clarifying FDI as a different phenomenon from capital flows, portfolio investment and TNCs. It identifies FDI as a unique/special phenomenon related to international production, revealing its significance, magnitude and direction. This chapter deals with the definition of FDI and Multinational Companies (MNC), parameters, importance of FDI, and discusses the restrictions imposed by developing countries on FDI.

Also Chapter Two attempts to assess the contribution of economic literature to an FDI explanation; this is done by exploring both international trade theories (traditional and modern). This chapter includes the important theories of FDI, the theory of FDI, the traditional trade theory, the modern trade theory, the comparative advantage theory, and provides a critical analysis of these theories. Also the chapter focuses on the literature review on FDI, provides a literature review on the relationship between FDI and economic growth, and a literature review on Chinese investment in Sudan.

Chapter Three is concerned with factors influencing foreign investment destination. It questions the extent to which empirical evidence supports the theoretical foundation to achieve the aim; the study displays FDI's present geographical distribution to examine the reliability of the theories' findings regarding FDI determinants and factors shaping the prevalent locational pattern.

Chapter Four provides an analysis of the advantages and risks of FDI for developing countries. This issue shall be discussed within this research from the point of view of the classical school firstly, then the researcher returns to present the most important

advantages that accrue to the developing countries from FDI, and also the most significant losses that they incur.

The first part of the thesis identifies and discusses the range of policies that governments in developing countries can implement to directly or indirectly influence inward FDI, as well as the behaviour of MNCs in the host market, the benefit of FDI in theory and practice, the policy as a part of a strategy, and the classification and implementation of policies affecting FDI in developing countries. The primary idea is that there are many ways in which governments can affect the behaviour of MNCs.

Chapter Five is mainly focused on methodology. It describes the method applied in researching this thesis. In conducting this research, a combination of qualitative and quantitative methods has been employed. The case study approach has been chosen to investigate the measures taken by the government of Sudan to encourage FDI and whether there has been any significant growth in the amount of FDI according to the influence of public policies on inward FDI flows. The sampling procedure is described, followed by the means of data collection. Methods of data analysis and limitations of the research are discussed. Finally, the framework for this research is introduced.

The second part of the thesis, Chapter Six, reviews the Sudanese foreign trade regime, examines its relation to the policy of liberalisation, the impact of these policies on the Sudanese economy, to what extent these policies attract FDI, and the result of these policies in the performance of the economy. The researcher finds that, as a result of the measures taken by the government, economic performance has improved in real terms.

Chapter Seven provides a broad overview of inward FDI patterns to Sudan over the period 1995-2010 and draws some preliminary inferences about the influence of public policies on inward FDI flow. The section 'foreign ownership policies in Sudan' discusses significant Sudanese government policy initiatives directed at influencing either the quantity or quality of inward FDI. They include the Investment Sudan Act. Specifically, it describes the main features of the Investment Encouragement Law 1999 (amended 2003) and its executive regulations. Foreign ownership policies in Sudan and how they might influence the magnitude and nature of FDI inflows to

Sudan are considered. This chapter focuses on the development and importance of FDI in Sudan; analysis, design, implementation and interpretation of results.

The researcher's idea is that, like many governments which recognise the importance of attracting FDI, Sudan has created a policy to attract multinational firms and to ignore grants and loans. The main objective of these policies is to enable economic activities to be mainly determined by market forces. The private sector plays a more active role in economic activities and large private capital inflows, including FDI and exports of oil, also increased.

Chapter Eight provides an assessment of Chinese investment in Sudan compared with investment from other international areas, and discusses the importance, growth, structure, trend and distribution of Chinese investment (notably investment in the oil sector), and trade, aid and development assistance to Sudan over the period 1997-2010. The researcher provides a more comprehensive analysis using the most recent secondary data to discuss the positive and negative impacts of FDI from China to Sudan.

The thesis explains that the various positive impacts of Chinese investment in Sudan and the opportunities for enhancing development in Sudan economy include the impact of oil in satisfying domestic consumption and the achievement of self-sufficiency; increasing government and public revenues; rapid and impressive economic growth as measured by the growth in the GDP and its composition and structure; increasing FDI, and increasing the volume of foreign trade as measured by the volume and structure of exports.

The research finds that, while oil has recently contributed to the improvement of economic performance in the country, the recent heavy dependence on it may lead to negative impacts and serious challenges for Sudan, since oil is related to potential north-south conflict and division of the country.

The researcher finds that Sudan directed itself towards the countries of South East Asia instead of Western European countries, as well as the US and Arab countries. The Sudan-China long-term partnership led to Sudan's real economic growth

averaging about 9% during 2005-2006, putting Sudan among the fastest growing economies in Africa (World Bank, 2008).

Chapter Nine focuses on the impact of the oil industry on Sudan's economy; the analysis in this chapter is based on the examination of the FDI effect on Sudan's economy during the decade 1997–2010. In this chapter, the FDI effect refers to the phenomenon that the initial Chinese investment in Sudan's oil industry brought; the direct effect of large revenues and the indirect effect of industrial linkages. The subsequent re-investment of the oil revenue by the government of Sudan and diversifying of foreign investment into non-oil sectors led to other industries taking off, and the emergence of domestic investment and local entrepreneurs.

Foreign investment in the oil sector provides a case study analysis of foreign ownership and the effects of foreign ownership policies. The following two chapters offer similar studies of the impact of FDI in the real estate and telecommunications sectors, respectively.

Finally, Chapter Twelve concludes the research with a summary and a set of policy recommendations.

## **Chapter 2**

### **FOREIGN DIRECT INVESTMENT IN THEORY**

#### **2.1 INTRODUCTION**

FDI, as a key element of globalisation and of the world economy, is a driver of employment, technological progress, productivity improvements and, ultimately, economic growth. It plays the critical role of filling the development, foreign exchange, investment, and tax revenue gaps in developing countries (Smith, 1997; Quazi, 2007). In particular, it can play an important role in Africa's development efforts, including supplementing domestic savings, enhancing efficiency, and raising the skills of local manpower (Dupasquier & Osakwe, 2003; Anyanwu, 2003).

FDI as an element of the rapid globalisation process has had significant increases over the last few decades. Global inward FDI flows rose from US\$ 54.1 billion in 1980 to US\$ 207.7 billion in 1990, reaching a peak of US\$ 1,401.5 billion in 2000. A fall ensued from 2001 such that, by 2003, it had dipped to US\$ 565.7 billion before peaking again at US\$ 2,100 billion in 2007. Estimates for 2009 put the fall to US\$ 1,114 billion, 2 billion of which was as a consequence of the financial and economic crisis (UNCTAD, 2010).

Currently, many world states are striving to attract FDI, due to the ensuing advantages such as technology transfer, employment opportunities, and encouraging market competitiveness; however, the subsequent discourse between the politicians and the economists in these states is rising around a number of major axes: (1) The motives of the foreign companies for investing in the host countries, (2) Determining the cost of/return on FDI, (3) Determinants and policies of FDI, and (4) Methods of organisation and administration, the exercising and implementation of functional activities in Multinational Foreign Companies.

This Chapter is mainly concerned with clarifying FDI as a different phenomenon from capital flows, portfolio investment and TNCs. It identifies FDI as a unique/special

phenomenon related to international production, revealing its significance, magnitude and direction. This chapter provides the definition of FDI and MNCs, parameters, importance of FDI and discusses the restrictions imposed by developing countries towards FDI. It includes the important theories of FDI, the theory of FDI, the traditional trade theory, the modern trade theory, and the comparative advantage theory and provides a critical analysis of these theories. Also, the chapter focuses on the literature review on FDI, provides a literature review on the relationship between FDI and economic growth, and a literature review on Chinese investment in Sudan.

With regards to the conceptual framework for this research questions, the present chapter sums up the literature as well as empirical studies on the relationship between foreign direct investment and economic growth, trying to arrive at a meaning relation eventually.

## **2.2 DEFINITION OF FDI AND MULTINATIONAL COMPANIES**

There is no unified and specific definition of FDI during this period. The terminology was used at the beginning of the 19<sup>th</sup> century, however, the economic literature distinguishes between Direct Foreign Investment and Indirect Foreign Investment (Portfolio Investment). The term Direct Foreign Investment (or Foreign Direct Investment, shortened to FDI) is generally utilised in two ways; the first one is related to the movement of capital and other resources across the border, and the second use is related to the laws and regulations that protect foreign investment, which is more comprehensive, as it includes capital and the control by the foreign investor of the remaining assets, together with the property rights and the contracting rights.

In many agreements for the encouragement and protection of investment, there exists a comprehensive definition, based on the ownership of assets. As an example, the Asian Promotion and Protection of Investment Agreement defines investment as all types of assets and it has a list of five groups of investments that includes: movables and non-movables, shares, bonds, mortgages, intellectual property rights, commercial activities, incentives, and claims of financial value. This definition does not require assets of financial nature and does not require reinvesting the revenues of previous investment (UNCTAD Scope and Definition, 1999).



It is important to define ownership and control in context with an MNC definition as it assists in the determination of the relations between investment in a specific country and the investor in another country so as to cover the investment by an agreement. The MNC differs from a regional corporation and from the strategic alliance; the regional corporation is owned by two individuals or more who enjoy the nationalities of a number of countries of the region. Many investment companies, such as regional corporations, have a number of incentives and advantages so as to encourage more regional cooperation, the agreement pertaining to the organisation of the investment of that company is of an encouraging nature. The strategic alliance concept is an alliance between a number of companies from different nationalities so as to coordinate their activities without any ownership or control links. The purpose of this alliance is to gain more markets or create some sort of forward or backward linkages. However, Direct Foreign Investment means ownership by the investor of a part or all of a specific project; the foreign investor controls the management fully in the case of wholly-owned project, or by participating in the management of the project in cooperation with a local partner in the case of joint venture investment. The foreign investor undertakes the transfer of some financial and technological resources together with the technical know-how in all fields to the host country. In contrast, Indirect Foreign Investment requires the ownership by the foreign investor of financial securities of a specific company without any intervention in the project organisation and its management and without intervention in its level of technology and the technical experience; Direct Foreign Investment is considered as a long-term investment, while Indirect Foreign Investment is considered as a short-term investment.

FDI is defined as ‘transfer of money from abroad in a natural form or in cash or both so as to establish a productive, marketing and administrative scheme on the long run and to interfere in investment’s decision making permanently so as to attain maximum profit through control and marketing of production units’ (Farag Izzat, Rida Al Adl & M. Bacionni, 2000).

The MNC was defined by Vernon (1994) as, ‘The organisation that its activities or sales exceeds US\$ 100 million annually, and owns facilities or productive branches in six foreign countries or more.’ From this definition it is clear that he focused on

several elements: the size of the company compared to its activities, its production or services activities in six countries or more (Froot, 1993).

### **2.3 FDI: GROWING IMPORTANCE**

FDI is growing in magnitude and importance, its proliferation all over the world is shaping the global economy and manoeuvring cross-border transactions.

During the period 1985-1990, FDI inflows annual rate of growth reached 20%, which exceeded by far the corresponding growth rate of world trade (5% per annum). Moreover, during 1991-93, FDI stock grew about twice as fast as worldwide exports of goods and services, and almost three and a half times faster than Gross National Product (GNP). In 1995, outward FDI stock hit a record of US\$ 2.6 trillion at the end of the 1980s (Balasubramanyam & Sapsford, 1994; UNCTAD, 1995). In addition, international production by TNCs (nearly 400,000 parent firms and 250,000 foreign affiliates) substantially affects cross-border transactions. Global sales generated by TNCs foreign affiliates were worth US\$ 4.9 trillion, US\$ 5.2 trillion and US\$ 6.0 trillion in 1992 and 1993 and 1994, respectively, exceeding at this level worldwide exports of goods and non-factor services, which were worth US\$ 4.9 trillion and US\$ 4.8 trillion during the same years. This implies that international production might dominate international trade in the future. Also, according to United Nations Conference on Trade and Development (UNCTAD) estimates, TNCs sales as a ratio to exports of goods and non-factor services represent around 131.5% and 133.5% for both developed and developing economies, respectively (UNCTAD, 1995; UNCTAD, 1996). The TNCs dominant role is also quite evident at the industry level. Taking electronics as an example, total sales by foreign affiliates of 23 electronics TNCs accounted for 80% of estimated world sales in this industry (UNCTAD, 1995).

Table 2.1 reveals further indicators reflecting the growing importance of FDI compared with GDP, gross fixed capital formation, exports of goods and services, etc.

**Table 2.1: Major Indicators of FDI Performance and Developments**

Item	Value at current prices, 1995a (US\$ billions)	Average annual growth rate (%)	
		1986-1990	1991-1994
FDI inflows	345	24.7	12.7
FDI outward stock	2,730	19.8	8.8
Sales of foreign affiliates	6,022 <sup>b</sup>	17.4	5.4 <sup>e</sup>
Royalties and fees receipts	41 <sup>d</sup>	21.8	10.1
GDP at factor cost	2,4948 <sup>d</sup>	108	4.3
Gross product of foreign affiliates	1,410 <sup>e</sup>	11.0 <sup>f</sup>	11.4 <sup>g</sup>
Gross fixed capital formation	5,681 <sup>d</sup>	10.6	4.0
Exports of goods and non-factor services	4,707 <sup>b</sup>	14.3	3.8 <sup>c</sup>

Sources: UNCTAD.

a- estimates b- 1993 c- 1991-93 d- 1994 e- 1991 f- 1982-989 g- 1989-1991

Note: not included in this table is the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and the sales of the parent firms themselves (UNCTAD, 1996).

Moreover, FDI's growing importance at the global level, and particularly for developing countries, has been greatly reflected in the 1990s, as it ranked as the first means of finance for these countries.

As illustrated in Tables 2.2 and 2.3, FDI has recently regained its importance as a large and growing source of finance for developing countries.<sup>1</sup> Before the Second World War, it played a greater role than financial institutions but, in the wake of the War and until 1973, official development assistance represented the bulk of total sources, as developing countries basically depended on official finance and, to a lesser degree, on commercial banks for development purposes.

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<sup>1</sup> In 1995, FDI represented the single largest source of net capital flows as it accounted for about 54% of the total flows (UNCTAD, 1996).

However, the 1970s and the early 1980s witnessed a drastic shift in the types of external financial flows to developing countries. They began to favour commercial bank loans. This shift reflects many factors, such as the growth of the Eurodollar Market, the recycling of petrodollars through commercial banks to developing banks to developing economies, and countries' preference for flexible bank loans rather than FDI, as the latter used to represent foreign control, inducing many countries to draw up restrictive codes for FDI.

**Table 2.2: Pattern of External Finance to Developing Countries; Gross Long-Term Flow (1971-1991)**

<b>Year</b>	<b>1971</b>	<b>1981</b>	<b>1991</b>
Total external finance (in US\$ billions)	19.5	156.9	205.3
FDI	12.3%	8.3%	16.5%
Grants	9.0%	7.3%	14.5%
Official loans	30.8%	26.0%	30.8%
Bonds	1.2%	1.2%	4.8%
Commercial bank loans	35.7%	46.1%	17.4%
Suppliers and export credits	10.8%	11.0%	12.3%
Portfolio equity	0.0%	0.1%	3.7%

*Sources:* WB, DRS and WB staff estimates (World Bank, 1993: 2)

However, in the 1990s, due to the debt crises in the 1980s, the pattern changed once again. Both commercial bank loans and official development aid was curtailed, the former due to non-repayment problems, and the latter because of restrictions imposed by the World Bank and International Monetary Fund (IMF) (Pomfret, 1993; Husted & Melvin, 1995). There was a radical shift from debt to equity financing and from bank to non-bank sources. Commercial bank loans were replaced by greater FDI flows, bonds, and equity portfolio flows (World Bank, 1993).

**Table 2.3: Aggregate Net Long-Term Resources Flows to Developing Countries, 1986-1993**

<b>Years</b>	<b>1986</b>	<b>1987</b>	<b>1988</b>	<b>1989</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>
Aggregate net long-term resources flow	63.9	67.8	74.0	79.5	102.1	121.1	156.6	176.7
Official developments finance	44.0	43.9	40.8	41.1	59.1	62.9	54.6	63.5
Private loans (net) and bonds	9.2	8.6	11.0	10.2	12.9	13.8	41.7	43.7
FDI	10.1	14.5	21.2	24.7	26.3	36.9	47.3	56.3
Portfolio equity investment	0.6	0.8	1.1	3.5	3.8	7.6	13.1	13.2

FDI Includes Reinvested Profits

*Sources:* World Bank 1993/94

In absolute terms, FDI flows to developing countries have increased more than any other source of finance as they more than doubled from an average of US\$ 20 billion in the second half of the 1980s to almost US\$ 47 billion in the first half of the 1990s, representing the largest source of finance for these economies (UNCTAD, 1995). Generally, this FDI upsurge could be attributed to several factors:

1. Since the 1990s, developing economies have begun to adopt pro-investment policies, to relax investment restrictions and to create a welcoming investment environment.<sup>2</sup> On the other hand, developed economies were somewhat suffering from recession during the early period of this decade.
2. Related to the previous factor, developing countries have recently begun to change their attitude due to an awareness of FDI's advantages. As a source of finance compared to loans, the former is often used in consumption spending

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<sup>2</sup> A completely different policy after the nationalisation waves that used to spread all through the 1960s and 1970s.

rather than investment. For this reason, FDI contribution to economic development is relatively more effective than bank loans. Also, with regard to payments, as FDI is equity finance, it is related to the economy's performance (in the form of profits and dividends), while in case of debt finance (bonds, bank and official finance), repayments are fixed regardless of economic conditions.

3. The recognition that the importance of FDI is not confined to its magnitude, growth and financial role has changed the perspective of most host countries. Developing countries have viewed FDI as a proper means of upgrading entrepreneurial skills, filling present technological gaps and improving marketing as well as managerial capabilities.
4. FDI's approval of any project does not require any interference from the World Bank or the IMF, as required for loans.

## **2.4 FDI: RECENT TRENDS**

FDI is a dynamic phenomenon that has experienced several changes over the past decades. This is quite evident from the recent ongoing trends relating to FDI's magnitude, sectoral pattern and spatial distribution.

### **2.4.1 Size**

The most popular image of TNCs is as 'giant' firms. In 1993, the top 100 TNCs, all from developed economies, accounted for nearly one-third of their combined outward FDI stock. Yet small and medium (SM) TNCs are playing a major role nowadays (UNCTAD, 1995).<sup>3</sup> They enjoy, however, certain distinctive characteristics, namely:

- SM TNCs tend to move first into neighbouring countries that reflect strong links, then spread later to other economies.<sup>4</sup>
- They tend to be less internationally diversified than giant TNCs.

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<sup>3</sup> The UNCTAD defines SM enterprises as 'an enterprise that has a home-base (headquarters or parent firm) in a developed country, with an employment level fewer than 500 people regardless of the industry and operates at least one affiliate in another country.' US SM TNCs started investing in 1920 while Japanese and European ones took a role just in the 1980s and early 1990s.

<sup>4</sup> For example, Canada served as the initial platform of small TNCs from the US.

- The principal advantage of SM TNCs include flexible management, organisational and market ability, reputation and customer relations.
- Some SM TNCs are highly specialised in niche products which give them relatively high market power in the elected market segments (UNCTAD, 1993).

#### **2.4.2 Sectoral Configuration**

The FDI sectoral pattern has been changing profoundly over the last decades. Firstly, the bulk of FDI used to be concentrated in the primary sector, reflecting both the industrialised countries demand for raw materials and their political dominance. By the late 1950s, there was a shift towards manufacturing which became the dominant sector of foreign investment activity in the following two decades.

The 1980s and 1990s witnessed another sectoral divergence, but towards services. This was quite evident in financial trade-related services, construction, tourism, public utilities and consultancy services.

More specifically, the change in the sectoral distribution of FDI can be clearly recognised when comparing the pattern of the 1970s and 1990s. In the 1970s, about 23% of world FDI stock was in natural resources, as compared to 31% in services. By 1990, the former represented only 11%, compared to 50% for the latter (UNCTAD, 1995).

In terms of flows, by the mid-1990s, the services sector represented around 60-65% of total FDI flows (UNTNC, 1988; Letto Gilles, 1992; World Bank, 1993; UNCTAD, 1996). This shift could be explained in the context of the following:

- The structural transformation of source-economies as reflected in the rising contribution of services to GDP.
- The nature of service expansion which is considered as a by-product of global proliferation of manufacturing.
- The favourable impact of technological advances of communications on services industry, which began to play a major role in international investment (UNTNC, 1985; Dicken, 1991; World Bank, 1993/94).

However, later in the 1990s, the widespread waves of privatisation and the relaxation of FDI inflows restrictions previously imposed by most home nations on certain sectors, began to attract foreign investors to the natural resources and extraction sector once again. For example, a large number of Latin America countries (Peru, Venezuela and Argentina) and the former Soviet Union countries have revised national legislation to allow oil exploration by foreign companies (World Bank, 1993/94).

Last, but not least, many developing countries have recently begun to allow foreign investors to participate in infrastructure projects. Between 1992 and 1994, infrastructure FDI outflows accounted for about 3-5% of total outflows for most developed economies. In the case of Japan, they accounted for about 7% of total outflows. This trend is anticipated to continue in view of the liberalisation policies of developing economies (UNCTAD, 1996).

### **2.4.3 Spatial Distribution**

FDI geographical distribution reflects a high concentration in developed countries, as they account for 94% of outward FDI stock, and about three-quarters of the global inward FDI stock.

Moreover, FDI is concentrated among the Triad (Japan, the EU and the US). The EU accounts for the largest share of both inward and outward FDI (39% and 45% respectively in 1994).<sup>5</sup> Japan, though a latecomer, represented the fastest growth, with a rise in outward flows from 14% in 1987-1989 to 23% in 1990-1992. It also ranked first in terms of annual flows of outward investment for the first time in 1988 (UNCTAD, 1995).

Nevertheless, FDI has been subject to changes in its geographical origins and destinations. Developing economies began to take their place on the FDI map, both as attractive locations for inward flows and as outward investors undertaking foreign investment. The major changes that occurred in the geographical distribution of FDI can be summarised as follows.

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<sup>5</sup> According to the United Nations (UN), the Triad represented about 78% of the total flow which amounted to US\$ 217 billion of FDI in 1990, about half of which were intra-Triad flows.



#### 2.4.4 The Increasing Share of Developing Countries

Developing countries have recently begun to receive a somewhat sizable share of FDI. Firstly, with regard to stocks, FDI inward stock recorded US\$ 500 billion in 1993 and US\$ 584 billion in 1994 which represents nearly a quarter of the global total. Secondly, in terms of flows, the share of developing countries has increased fourfold between 1986 and 1993, reaching a record of about US\$ 90 billion in 1995. Today, developing economies receive twice as much as the value of world FDI flows in 1986. The rates of growth of FDI flows to developing economies were 34% and 15% in 1993 and 1994 respectively, hitting a record of US\$ 73 billion and US\$ 84 billion in the same years. This record is a reflection of improved macroeconomic policies and the speeding up of privatisation programmes which accounted for about 8% of total FDI flows in 1993 in developing economies (UNCTAD, 1995). Table 2.4 reports the change and annual increase of FDI from 2000 to the year 2008.

**Table 2.4: Rate of Change and Annual Increment of FDI (in US\$ billion)**

Year	Size of FDI	Rate of change	Annual increment
2000	1,381	-	-
2001	820	-0.407	-561
2002	629	-0.233	191
2003	565	-0.102	64
2004	734	-0.30	169
2005	973	-0.32	239
2006	1,461	-0.50	488
2007	1,978	-0.35	517
2008	1,697	-0.14	281

*Source:* UNCTAD International Report on Investment Geneva 2009

From the schedule above, we can see that the rate of change in the size of FDI fluctuates year to year, and the ratio of annual increase also fluctuates, where it hit its maximum ratio in the year 2007 against the lowest ratio registered in 2001. This is

due to the reluctance of private capital to go into direct investments. Table 2.5 reports the Share of Developed Countries in FDI.

**Table 2.5: Share of Developed Countries of FDI (in US\$ billion)**

<b>Year</b>	<b>FDI inflow</b>	<b>Share of developed countries</b>	<b>%</b>
2000	1,381	1,117	80.9
2001	820	595	72.6
2002	629	442	70.3
2003	565	361	63.9
2004	734	414	56.4
2005	973	613	63.0
2006	1,461	972	66.6
2007	1,978	1,358	68.7
2008	1,697	962	56.7

*Source:* UNCTAD Investment Report 2009

From the above schedule, we see that the size of the inflow of investments into developed countries fluctuates, hitting its peak of 80.9% in 2000 while the lowest percentage, 56.4%, was registered in 2004. In spite of being the lowest ratio, this figure is still more than 50%, a fact which indicates the dominance of large countries over the greatest magnitude of FDI. Table 2.6 reports the Share of Developing Countries in FDI.

**Table 2.6: Share of Developing Countries in FDI (in US\$ billion)**

<b>Year</b>	<b>Size of foreign investments</b>	<b>Share of developing countries</b>	<b>Percentage</b>
2000	1,381	256	
2001	820	215	-16
2002	629	175	-18
2003	565	183	46

<b>Year</b>	<b>Size of foreign investments</b>	<b>Share of developing countries</b>	<b>Percentage</b>
2004	734	290	58
2005	973	329	13
2006	1,461	433	31
2007	1,978	529	22
2008	1,697	620	17

*Source:* Development (UNCTAD) International Report on Investment Geneva 2009

From the above schedule we can observe that FDI is increasing, which reflects the will of foreign countries to invest in developing countries if there is the availability of a good climate for investment and agreement on taxes treatment, in addition to other privileges. Table 2.7 reports the Size of FDI Attracted by Developing Countries

**Table 2.7: Rate of Change in FDI Attracted by Developing Countries (in US\$ billion)**

<b>Year</b>	<b>Size of FDI</b>	<b>Inflow to developing countries</b>	<b>Percentage of annual increment</b>
2000	1,381	256	18.6
2001	820	215	26.3
2002	629	175	27.9
2003	565	183	32.4
2004	734	290	39.5
2005	973	329	33.9
2006	1,461	433	30.4
2007	1,978	529	26.8
2008	1,697	620	36.6

*Source:* UNCTAD International Report on Investment Geneva 2009

From the above-mentioned schedule we can see that the percentage of the annual increment in the size of FDI in developing countries has been in a constant increase mode in the period between 2002 and 2008.

#### **2.4.5 The Emergence of Developing Economies as Home Countries**

The emergence of TNCs from developing countries, particularly newly industrialised countries, is one of the major changes that have been taking place since the mid-1960s. It reflects the need of developing economies to compete internationally, so as to gain access to markets and resources.

Their share of global FDI flows rose from 1.04% to just 2.37% over the period 1960-1980. Then, it doubled from 5% (on average) during the period 1980-84 to 10% in 1990-94 (Ansari & Singer, 1988; Colman & Nixon, 1994). Yet, developing economies' share of global FDI outward stock is still negligible (not exceeding 5% in 1993). This does not reflect their investment potential in the global market.<sup>6</sup> Compared to their share in global exports (23%) and global GDP (21%) in 1993, their share in FDI outflows is still as low as 6% (UNCTAD, 1995).

The FDI pattern of developing countries reveals great geographical concentration. China, Hong Kong, Republic of Korea, Singapore and Taiwan are responsible for 71% of outward FDI stock and for 90% outflows from developing economies in 1993. Most FDI originating in these economies is directed towards other developing countries. However, in recent years, some developed countries have tended to receive a growing share.<sup>7</sup>

Last, but not least, the role of developing economies as home countries is expected to grow in the near future. The prospects seem bright, at least for two reasons:

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<sup>6</sup> Most of them have succeeded in creating a niche for themselves and have a comparative advantage in their special acquaintance with other developing countries. They also managed to overcome barriers of international advertising and mass promotion by improving their ability in developing informal marketing networks.

<sup>7</sup> As TNCs from these economies, especially Taiwan, have recently tended to move towards Europe. Also, about half of Korean FDI in 1992 was in industrial economies, mostly Europe and the US (UNCTAD, 1995).

1. The opportunities and pressures of a liberalising and globalising world economy drive firms to complement their ownership assets with locational ones to be able to compete with international rivals.
2. As countries develop, firms are able to acquire and gain more ownership specific advantages (UNCTAD, 1995).

## **2.5 THE OBJECTIVES OF FDI**

The objectives and benefits of FDI sought by the foreign investor are as follows:

1. To obtain raw materials from the host countries in order to use them as inputs in the industry.
2. To find new markets for foreign companies to sell a surplus of goods and commodities which were unable to find a market at home (Golfer, 1995).
3. To enjoy the privileges of low-cost production in the host countries of investment, where labour costs are much less than that in the industrialised countries.
4. To benefit from the ease in investment laws granted by the developing countries in attempt to encourage and attract foreign investment; these privileges range from tax incentives, permanent investment opportunities, giving warranties to the investors, and providing good information systems.
5. To benefit from opportunities of profit maximisation, which foreign companies acquire, and could be much more than these companies could gain at home.
6. Weakness in the competitive status of the local enterprises, which can easily be overcome by the foreign companies, in term of quality, prices and services, due to the advantages of technology and their financial capacity (availability of the capital).
7. To reduce the risks of investment by spreading the investment over a number of countries.

The motives of the host countries in which investment is taking place which prompt their acceptance and encouragement of investment by foreign companies in their lands can be detailed as follows:

1. To benefit from the high-tech and management experiences of the foreign companies, which can contribute to the transfer of technology, expertise and know-how. It is also depends on the ability of the host country and its nationals to assimilate the new information and technology.
2. The desire of the multinational companies to respond to the interest of the host countries in technology transfer (Golfer, 1995).
3. The policy of the host countries towards technology transfer, and creation and digestion of information.
4. The ability of the host countries to assimilate the technology transfer, which depends on the nature of the investment projects and the desire of the nationals of these countries to accept basic learning and labour in modern projects. The assimilation of high-tech in projects, such as the chemical industries and steel requires a staff of skilled labourers and engineers highly trained to be able to assimilate the new techniques.
5. To contribute to solving the problem of unemployment by recruiting large number of people in established investment projects.

## **2.6 THE PARAMETERS OF FDI**

Many of the recent studies have focused on the factors of attracting FDI into the host country, taking into account the natural advantages enjoyed by the host country such as cheap labour. These studies also focused on the importance of the market and the possibility of growth as one of the influential factors in the directions of the foreign investments (Abugahaf, 2001).

However, the investment growth and its continuous inflow into the developing countries in general, and the Arab countries in particular, is subject to the extent of relevancy of the investment atmosphere, which can be defined as a comprehensive concept including all situations and circumstances surrounding the investment process, such as the political, economic, social, administrative and legal factors, all of which can determine the chances of success or failure of the investment.

The most significant parameters of the investment process are macroeconomic policies and the extent of their realisation of economic stability, plus the legal and

organisational framework and the activities of scientific research and technological development (Abugahaf, 2001).

Here are the most important parameters in attracting FDI into developing countries.

### **2.6.1 Market Size and Possibility of Growth**

Size of the market and the possibility of growth is one of the factors that can affect the decision to initiate FDI, thus the size of the current or expected market would lead to the increase of the capital inflow. It is also one of the indexes that have been used to measure the size of the local market and the income per capita in comparison to the national domestic product and the size of population.

The first index can be considered as an indicator of the current demand, while the second index is an indicator for the absolute size of the market; hence it also outlines the future probabilities (Abugahaf, 2001).

The studies have revealed that there a correlative relationship between the product growth rate as an indicator to measure the market of the host country and the FDI, where the increase in these factors would increase the chances of improvement and progress of the national economy, hence attracting more foreign investments to satisfy the new desires that might be generated as the result of the growth in these factors (Alessandrini & Resmini, 2002).

### **2.6.2 Stability of Macroeconomic Policy**

The presence of an investment-attracting economic structure, stable and steady, is one of the basic factors in encouraging investment in general, and FDI in particular, as such an economic structure generates positive signals for both local and foreign investors. It focuses interest in the liberalisation of the economy and its openness towards the world, which represents a basic requirement for the inflow of investment. This situation can be achieved through the application of economic reform programmes to control inflation, and any deficit in the budget or trade balance (Alessandrini & Resmini, 2002).

### **2.6.3 Implementation of Economic Reforms**

The implementation of privatisation programmes is a complementary policy to the implementation of economic reforms in the world's developing countries, since it is an indicator of the inflow of foreign investments by creating opportunities for international investors to access local markets, and to contribute to the economy. This can be achieved by removing barriers to investment by giving new investors the impression that the government is welcoming to foreign investment, particularly in the basic infrastructure and the improvement of services pertaining to privatisation (Alessandrini & Resmini, 2002).

### **2.6.4 The Legal and Organisational Framework of Investment**

The provision of a legal framework to govern the activities of direct investment is one of the crucial elements in the success of foreign investment. Setting up a legal framework so that is an attracting factor for investment can be as follows (ECAWA Report UN, 2000):

1. The framework should be stable, transparent, clear and not contradictory of other legislation; it should also be relevant to international rules and regulations aimed at the protection of investment.
2. There should be provision of enough guarantees to protect the investor against certain risks such as nationalisation, confiscation, and dismantling of ownership, and also the guarantee of freedom of transferring the profits outside the country, freedom for capital to enter and leave, plus a system of protecting intellectual property rights.
3. There should be an effective judicial system able to enforce the laws, contracts and resolution of disputes which may arise between the investors and the host country.

The organisational and institutional environment also significantly affects FDI inflows, as it affects the cost of transactions, increasing/decreasing the degree of satisfaction of the potential investors. This system should be clear and convenient, free from bureaucracy and characterised by its simplicity; it should be enabled by creating a one-step process window within the government's structure to attract more



investments. Availability and accessibility to data and information at the right time will also be an asset in attracting even more foreign investors.

### **2.6.5 Convenient Infrastructure**

The availability of convenient infrastructure is a basic element in attracting FDI as it can contribute to the reduction of the cost of labour and hence increase the rate of returns on private investment. Well-established transport and communications infrastructure is likely to help accessibility into areas within and outside the host country, while the presence of efficient means of communication will facilitate easy and quick contacts between the different branches of the MNCs and will also help smooth flow of information and data between a Head Office and branches.

### **2.6.6 Development of Manpower and Support of Capabilities of Technology Development**

The availability of well-trained and qualified labour is one of the important elements in attracting FDI, while increasing local investment in research activities and development plus establishing centres for scientific research can be taken as an important index for the decision-makers in opting for investment in one country rather than another; this reflects the ability of the country to better adapt to modern production methods and assimilate new technology.

### **2.6.7 Finance and Monetary Incentives**

Incentives which developing countries give to MNCs play an important role in attracting foreign investment; these incentives would be of great value if meant to offset the lack of other relative advantages in the countries hosting the investments (Singh, 1995). These incentives can be financial and/or monetary remission.

Financial incentives include waivers and remission from tax, whether temporary or permanently set on investment, early depreciation of capital assets, waivers on imported capital goods or from other imports taxes, in addition to incentives on exports and other privileges set to encourage investment.

Finance incentives may also include direct assistance which the government grants to cover part of the cost of the capital, production or the cost pertaining to the marketing expenses, plus the government stake of shares in investment projects which involves high commercial risks. The government also gives insurance with preferential advantages to cover certain kinds of risks such as a change in foreign exchange rates, and non-trade risks such as nationalisation and confiscation (Hamid El-Arabi El-Hadari, 1998).

Other incentives also include preferential treatment for FDI, such as easing money and profits transfer, the provision of main services for the investor, the execution and administration of projects and furnishing investors with market information, providing raw materials, presenting advice on production and marketing, assisting in training, and providing basic infrastructure at competitive prices. These incentives may indirectly contribute to decreasing the cost of projects and the possibility of achieving high returns.

#### **2.6.8 Strengthening Regional Economic Cooperation**

Efforts aimed at activating economic integration between developing countries are one of the most important elements in attracting FDI into these countries. As for the Arab countries, the success of the steady efforts aimed at the creation of a Joint Arab Market would increase Arab joint projects and, at the same time, create a large regional market which could effectively contribute to trade talks with foreign investments which might flow into the Arab world (Amira Hssab Alla Hamad, 2005).

#### **2.7 RESTRICTIONS BY DEVELOPING COUNTRIES TOWARDS FDI**

Developing countries employ different political tools to ensure that the behaviour of the investment companies is aligned with their desired objectives, as follows:

- Requirement of performance.
- Laws of assimilation.
- Control on profit transfer to outside.
- Taxes incentives.

Requirements of performance can be detailed to suit each field of industry, such as a car assembly company being obliged to gradually add more locally-made components into the car, and mining companies being asked to make future commitments to have their future investment financed locally.

### **2.7.1 Restrictions**

Restrictions aim to encourage policies which require the companies to recruit more local staff in their operations; this policy is not only confined to the creation of jobs but also aims to increase the ability to assimilate technology through these companies. Some governments force companies to invest in certain training programmes; an example of this is the oil sector in Indonesia (Golfer, 1995).

Developing countries have requested a number of requirements aiming to transfer technology, in addition to training programmes. Some countries have obliged the companies to bring the most modern machines into the country and refused to allow old ones.

There is another commonly used policy which partially targets technology transfer - the insistence of developing countries on accepting foreign companies only as partners to national companies in joint ventures, in what is known as laws of assimilation. These stipulate that MNCs shall sell an agreed stake to the national companies of the host country; this philosophy is based on the notion that national companies have the ability to digest and control the incoming technology, hence using it locally, but many of the local partners enter into business with the MNCs based on their relations with the political centres so they are likely to be inexperienced in the business sector. MNC headquarters are also hesitant in allowing transfer of technology via joint ventures, and prefer operating through their solely-owned branches.

Other restrictions imposed by developing countries come in the form of an upper limit on profit transfer, aiming at reducing the outflow of resources from the developing countries to the outside world; this policy is largely used in South America and India.

### **2.7.2 Tax incentives**

Developing countries should make available for companies which fully comply with the requirements a package of positive incentives, such as tax remission and other privileges, such as a monopoly on the local market and assurance for the transfer of profits.

Tax incentives are most commonly used by countries to attract MNCs, where tax remission is always conditional and dependent on the foreign company working in a certain area, usually poor or underdeveloped areas.

### **2.7.3 Hindrances to foreign investment and arbitration**

We discuss here the barriers to FDI that face foreign investors in general, and Arab investors in particular. There are a number of policies and processes which come together to create obstacles to the smooth inflow of capital and investments to host countries.

In spite of efforts by all governments, there are still some hindrances that should be eliminated through employment of certain measures and procedures to achieve the desired objectives:

1. Weakness in the infrastructure of the most countries, such as roads, airports, services and transportation.
2. Lack of political stability with many disputes and conflicts (Abubakar Adam El-Tahir, 2001).
3. Intricate and complex regulations and legislation governing investment activities, which are also subject to sudden change at any time, something that may provoke the concern of investors. In most cases, governments of developing countries opt to monopolise some of the activities with claims of strategic oversight.
4. Weakness in the incentives and privileges given to the foreign investments, which leads to the reluctance of the foreign investors to invest, instead looking to better conditions in another country.

5. The number of government departments concerned with investment, which prolongs the process and makes it more complicated.
6. Lack of information necessary for investment decisions and the absence of information on specific investment projects is regarded as one of the main obstacles to investment.
7. Difficulty in obtaining the necessary licenses for investment projects as the result of unhelpful processes and practices by the authorities concerned, which wastes the time of the potential investors.
8. The lack of a proper banking system and the prevalence of traditional banking systems in most developing countries, including Sudan, which does not meet the need of foreign investors for quick transfer of profits, or making available required funds in a timely fashion (Ragab El-Bana, 2001).
9. Weakness of the local market, in that it does not accommodate large scale production of the foreign projects. This is a result of the weakness of the purchasing power and would oblige investors to look for outside markets, adding more cost to the products, hence reducing profitability.
10. A policy of nationalisation and confiscation of projects indicates a lack of respect for people's rights and lessens the investor's confidence.
11. The local population's tendency not to respect the foreign investments might threaten the life of the investors. This has happened before, when some foreign investors were confronted by the local population in Sudan.
12. If there is a lack of economic stability with swings between inflation, recession and deflation with no clear governmental policy, this will make the investor cautious. Likewise, a lack of security could jeopardise the safety of the investors.
13. Non-availability of foreign currencies in the host country may prove a barrier to the investor in acquiring some of materials and requirements of the project,

in addition to the devaluation of the local currency which results in degeneration of the profits of the investors when transferred abroad.

14. Lack of a skilled workforce for the investment would concern investors; lack of experience in working with foreign investors and restrictions on foreign labour might be a barrier where some countries make it obligatory to employ the local population to control high unemployment (Arab Authority Investment Report, 2001).
15. A double tax system whereby the government can impose more than one form of tax on the product produced by the foreign investors in spite of the remission granted for these projects.
16. Lack of a clear investment programme in many countries means the absence of clear investment policies and priorities. In addition, an investment plan and investor directory, including the country's potential and investment opportunities and descriptions of infrastructure are necessary for decision-making by potential investors.
17. Restrictions imposed on the movement of the business people, whereby the authorities at the airports do not easily allow investors into the country.
18. Restrictions imposed on profits and money transfer to outside countries and the conditions that must met before making any movement like this.
19. Restrictions on imports and exports; some countries restrict exports by investors when seeking markets, or impose more tax on these exports on the grounds that these exports can allow the escape of capital outside the country.
20. Weakening of the finance incentives by decreasing government grants such as credits and securities from the banks, plus securities on credits from international finance institutions and government grants for training and reductions in the cost of services such as electricity, water and drainage (UNCTAD, 1995).

21. Weakness of promotion is one of the main problems for investors in many of the countries; the media is unable to reflect the country's investment potential to potential investors and the incentives and privileges given to encourage the investors, in spite of the fact the investment law in Sudan is regarded one of best in comparison to others in term of incentives and privileges.
22. Weakness of the stock markets, in comparison with the developed countries which take much more account of the large role played by these markets in trading with shares, bank securities and banknotes. They also protect investors and inform people of trade transactions, and help acquire monetary resources for the public and private enterprises by making available more liquidity for the tenders issued by these enterprises.
23. The state's fiscal policy retreat, where any decrease in the size of the government expenditure in different economic sectors would have negative effects, such as a delay in spending on infrastructure projects would have negative effects on other projects pertaining to it (El-Mahar, 1981).

## **2.8 THE THEORY OF FOREIGN DIRECT INVESTMENT**

As a result of FDI's widespread implications for world trade, technology disseminations and internationalisation, many economists have displayed great interest in explaining different aspects of this phenomenon, albeit adopting different perspectives.

On the one hand, some economists view FDI as a transfer of resources across national boundaries; hence, it was studied in the context of international trade theory. On the other hand, another group regard FDI as a means of extending firms' boundaries, thereby it was studied in the context of firm theory. No attempt, to our knowledge, has been made so far to provide a comprehensive explanation of FDI that encompasses both theories.

Early research on the impact of 'factor movement', conducted by trade theorists, focuses on factor cost advantage promoting international trade, given factor immobility. For example the Heckscher-Ohlin-Stolper model, developed in the 1930s

predicts that, given identical constant return to scale production functions in two competitive economic spaces, the with-trade ‘spatial equilibrium’ is characterised by factor income equalisation and the locally-scarce factor of production will be worse off. However, the work of Losch (1939), subsequently integrated into the theory of location, implies that, for two comparably endowed economic spaces, if trade takes place, along with factor mobility, and a typical producer is able to lower the average production and/or transport costs, then the spatial equilibrium will be consistent with a hierarchal ranking of the productive units, ordered by their average production and transport costs. Such ‘spatial equilibrium’ of ‘natural monopoly’ is not consistent with factor income equalisation and, in a dynamic setting, may develop backlash effects leading to polarisation between and within economic spaces. These theoretical inputs provided the intellectual source for subsequent researches on factor movement embedded in FDI.

Historically, the investigation of the outcome from FDI in Lesser Developed Countries (LDCs) involved cost-benefit analysis of individual FDI projects, as well as the overall effect of the FDI flow on growth of the host. The former concept arose out of a need to quantitatively assess whether a person, business or society at large would experience a net benefit or net loss from a given project. Protocols of this analysis have evolved over time and been increasingly adapted for more complex cases. Lall and Streetan (1977) provided an example of FDI assessment using the cost-benefit approach. At a macro-level, early growth literature, focusing on LDCs, upheld that the inflow of FDI could augment the marginal productivity of labour (the ‘abundant factor’), and reduce the marginal product of capital (the ‘scarce factor’). Other benefits may include higher tax revenues, especially from private FDI (if it is not attracted in the first place by low tax), and a know-how spillover effect on domestic firms through the technological demonstration effect or through pressure that compels them to adopt more efficient methods (MacDougall, 1960). These views were also articulated in the two-gap model developed by Chenery and Strout (1966) on account of developing countries suffering from shortages of both savings and foreign exchange. The most benign model of FDI along these lines contends that the potential host is caught up in a poverty-laden equilibrium, with low productivity levels leading to low wages and thereby low levels of savings and investments which in turn result in perpetuating low



productivity. FDI can break this cycle by complementing domestic savings and supplying more efficient and effective management, products and production technologies (Cardoso & Dornbush, 1989).

Early writings on FDI also consider firm-specific motives for internalisation. Vernon (1966), for example, points to the potentials of realisation of economies of scale that reduce average cost as an explanation for the internalisation of firms. He argues that products pass different stages of development and that demand may vary across countries, hence firms would be able to exploit economies of scale by expanding production abroad. Another explanation that draws on the theory of organisation postulates that an internationalising firm could exploit imperfections in the local product and factor markets (Hymer, 1976).

In late 1970s, Dunning developed an eclectic approach, which is often used to explain the reasons for FDI, the factors determining its level and how it may impact the host country. The approach draws on various theoretical stands: trade theory, organisation theory, internalisation and transaction cost theories. Dunning's approach postulates that, for a typical firm, FDI is motivated by holding an ownership specific advantage (O) the firm wants to exploit in foreign location (L) but cannot do this 'advantageously' except through internalisation (I) (Dunning, 1979, 1981). The OLI framework could be highlighted in the following: first, a firm may possess net ownership advantages vis-à-vis firms of other nationalities in serving particular markets. These firm-specific advantages largely take the form of the possession of tangible or intangible assets such as knowhow, brand name, and scale economies that, at least for a period of time, are exclusive or specific to the firm possessing them. Second, the firm would seek a host country which demonstrates relative country-specific advantages over others in terms of infrastructure, resources, policies, culture, attitudes and so on. Third, assuming the first and second conditions are satisfied, the firm has to decide on the entry mode. It would be more beneficial to the enterprise possessing these advantages to use them itself rather than selling or leasing them to foreign firms. That is, the firm prefers to internalise its advantages through an extension of its own activities rather than externalise them through licensing and similar contracts with independent firms. Utilisation of these advantages may be in conjunction with some factor inputs (including natural resources) outside a firm's

home country; otherwise foreign markets would be served entirely by 'trade' and domestic markets by domestic production. The strategies and tactics of MNCs vary and may include the following four groups of motives: natural resource seeking, market seeking, efficiency seeking, and strategic asset seeking.

The OLI framework was extended on many occasions; first, the IDP was introduced to impart dynamics to the basic OLI. The IDP attempts to explain the link between the net-FDI (i.e., outward FDI minus inward FDI) and the level of development (Dunning, 1981, Dunning and Narula, 1996, 2004). The IDP postulates five stages where FDI remarkably changes patterns as a country develops. In the initial stage, the host attracts very little FDI, if any, and when it occurs, it is mainly inward FDI to exploit available comparative advantage, typically in the natural resource sector as intra-industry investment and trade are very low. In the second stage, the country develops certain advantages that attract some MNCs to move in. These advantages are typically undifferentiated, e.g., cheap but unskilled labour, emergence of sizable market for MNCs to take advantage of due to the increasing intra-industry trade, but as the (O) advantage is very weak, no outward FDI takes place. If it happens, it is still small and directed to countries at a similar stage in the IDP. In the third stage, both intra-industry investment and trade are increasing; the host is able to create sophisticated and differentiated advantage through infrastructure and human capital development. These 'created assets' attract market-seeking MNCs but also, increasingly, efficiency-seeking ones. Outward FDIs also take place at this stage and are directed mainly to developing countries or to countries at a similar stage of IDP, but are also increasingly aiming at acquiring more advanced countries' strategic assets, which can further develop domestic firms. In the fourth stage, a strong industrial base is developed and the country engages in massive outward FDI targeting advanced countries, hence it becomes a net exporter of FDI. In the final stage, as is the case in the now advanced countries, there is increased convergence in inward and outward flows.

The OLI-IDP framework not only provides an explanation of FDI and its likely impact on the host and how the individual components of the OLI changes with stages of development, but it also furnishes a base for policy interventions at any given stage in terms of creating the prerequisites for a move to a higher level of the IDP, as well

as attracting MNC-related development strategies in which the host is interested (Narula & Dunning, 2009).

Another extension attempts to incorporate the political factors that are likely to influence the MNCs (Jean, 1988). Even Dunning's (1981) eclectic approach refers explicitly to government interventions of various kinds when discussing the sources of ownership, location and internalisation advantages. However, these sources are essentially assumed to be exogenously given to the MNC.

Jean's (1988) argument is that ownership advantage should be extended to include political 'knowledge or expertise'. These political advantages can take the form of better intelligence about political actors and opportunities, as well as more ready access to political opinions and decision-makers. Rugman (1981) considered these political resources as 'intermediate products' whose market could be internalised by the MNC. But why is the MNC better off vis-à-vis the local firm in developing and using these political knowledge and expertise, while the latter firm is more familiar with domestic political resources and enjoys favourable nationalistic sentiment? In this regard, it is hypothesised that the MNC overcomes this disadvantage on the basis of greater resources; support from their home state and multi-nationalisation. Internationalisation helps explain why the ownership of better political intelligence, access and influence skills are often built into the hierarchy of the MNC (Jean, 1988). A widely debated extension of the OLI emerges from a recent strand of literature in connection with the Third World MNCs emanating mainly from China and India. For instance, Mathews (2006) showed that these firms are characterised by an ability to internationalise very rapidly, while undertaking organisational innovation through networking, and hence the OLI may not adequately describe the behavior of the Asian latecomers. Mathews suggested an alternative LLL model to account for the sources of advantages of emerging MNCs, namely, (1) Linkage: the ability of these firms to focus not only on their own existing advantages, but more on how to acquire external advantages through linkages; (2) Leverage: ability to leverage resources through networking rather than gaining advantage from internalisation; and (3) Learning: ability to learn, imitate and build advantage from know-how in linkages and leveraging processes. However, the LLL could be taken as an explanation of the sources of ownership advantage rather than an extension of the basic framework.

In a recent contribution, Narula and Dunning (2009) showed how globalisation and networking influence the nature of OLI comparative advantages. *Inter alia*, value-adding activities become increasingly knowledge or information-intensive. Accordingly, the firm-specific intangible assets, especially intellectual capital, have become more mobile, and the host L advantage is increasingly weakened. The governments of the developing countries now increasingly compete with each other to attract mobile investment.

## **2.9 THE MOST IMPORTANT THEORIES OF FDI**

There are many points of views about the viability of FDI, which are outlined below (Negandhi & Baigon, 1981).

### **2.9.1 Classical Theory**

Classical economists believe that FDI entails various benefits, which return to MNCs; foreign investment is a game having only one winner which is those companies and not the host countries. Classical economists depend on a number of justifications:

1. Technology transfer by MNCs is dominated by a technology level not appropriate to the required levels for economic and social development in the host country.
2. MNCs tend to transfer maximum profits from its investments to the mother country, instead of reinvesting it in the host country.
3. The presence of MNCs leads to unequal distribution of income between individuals of the society, offering high wages as compared with local companies, leading to the creation of a new social class.
4. The production of MNCs leads to the creation of a new pattern of consumption in the host countries that does not match comprehensive development policies in these countries.
5. The presence of MNCs leads to the dwindling sovereignty of the state and its independence and, where the development of technology depends on a foreign state, it also assists in the support of economic dependency, which might lead to pressure on the political forces in the host country.

The researcher is of the view that the risk of marginalisation is more harmful to developing countries than subordination (assuming that FDI leads to subordination or dependency). Sovereignty is not as it was, which is the case for all countries, whether developed or developing, and FDI is not usually for the benefit of a specific country as companies tend to strive for profit wherever they are, irrespective of the degree of the benefits for the host country. The degree of growth in the host country therefore depends on the policies implemented by it, the incentives granted for the MNCs and whether common interests were maximised for both the country and the company, which depends on the country rather than the company (Alam, 1992). The classical school of thought was affected by the general climate of investment in a previous period, while international changes increased the importance of these investments. However, the risks raised by the classical school are not as severe as before; the creation of certain patterns of consumption are due to the media more than to MNCs.

### **2.9.2 Modern Theory**

This theory is based on a principal assumption, that all parties of investment (Multinational Companies and the host country) are linked by common interest, each one of them benefits from the other to attain an objective or a group of specific objectives. In other words, there is no one winner as assumed by the classical school of thought; it is a game, where each party accomplishes many benefits. However, the size of outcome attained by each party depends on the strategies and practices which symbolise the basis and essence of the relation between them (Abou-Khaf, 1985).

The proponents of this theory believe that FDI in the host country assists in attaining the following:

1. The flow of foreign capital.
2. Participation in capacity building of local human resources.
3. Transfer of technology in the fields of production, marketing, administration and others.
4. Exploitation of financial resources, as well as benefiting from human resources in these countries.

5. Participation in the creation of economic relations between the production sectors and services inside the specific country which facilitate the desired economic development.
6. Creating new export markets, leading to the creation and development of economic relations with other foreign states.
7. Decrease in imports.
8. Based on the above benefits, the balance of payments will be improved in the host country.
9. The economic, political and social development in the host country depends greatly on the above mentioned outcome.

The ideas of the new economic theory are supported by much practical evidence. Currently many states compete for the attraction of foreign investment which is, in reality, encouraged by the grant incentives, guarantees, and various facilities for the foreign companies and Multinational Companies.

In spite of the differences and conflicts of interests between the objectives of Multinational Companies and host countries, the controversy about the viability of relations between these parties might depart from objectivity. In this respect Zenoff, Negandhi and Baliga (1981) indicate the following:

1. For host countries to achieve the maximum benefits or to maximise its revenues, it needs to try and impose certain conditions on the Multinational Companies so as to increase employment opportunities, participate in the capacity building of human resources and carry out programmes of research and development (R&D) in the fields of production, sales, promotion of national participation in investment, the development of local resources and its exploitation, improvement of products, increase in exports and decrease in imports.
2. At the same time, it was observed that Multinational Companies demand from host countries a reduction in bureaucracy, the provision of all services related to infrastructure, improvements in the special conditions of work, and diminishing control on production, marketing and other activities, in addition to absolute ownership of investment projects.

The researcher is of the opinion that, when analysing the objectives of each party (host countries and Multinational Companies) and taking the requirements such as procedures and decision-making into account, such procedures reveal the expectations of each party to the other, therefore the narrowing or widening of the unconformity gap between the expectations of host countries and Multinational Companies depends greatly, not only on the set objectives, but also on a better understanding of the common goals between them.

### **2.9.3 The Comparative Advantage Theory**

Ricardo's comparative theory (1817) is one of the most important traditional trade theories that represent the core of the literature. It provides the fundamental explanation for international trade. According to Ricardo, international trade takes place as a result of countries' different comparative advantages, which are attributable to international differences in labour costs; the latter arising from a disparity in labour productivity which reflects, in turn, technology and production function differentials.

In the context of his theory, each country is likely to specialise in the production of a commodity in which it enjoys a comparative advantage. As a result, total world output per commodity would increase, and all nations would be better off (Hood & Young, 1979; Krugman & Obstfeld, 1988; Chacoliades, 1990).

Indeed, the comparative advantage law is signalled out as Ricardo's greatest contribution to economic thought. It has been represented as the core of all international trade theories. In fact, he has motivated his successors to follow the same path using the concept of comparative advantage. For instance, some have offered different explanations for the comparative advantage as H/O has, as illustrated below. Haberler (1930) widened the concept itself. He rejected Ricardo's emphasis on labour as the only production factor. Instead, he recast the comparative advantage in terms of the opportunity cost. Each country should specialise and export commodities in which it enjoys the lowest opportunity cost (Chacoliades, 1990).

Being limited to classical assumptions, Ricardo thereby could not provide any explanation for FDI. Firstly, he assumes the labour is the only factor of production, thereby ignoring other factors (e.g., capital). Secondly, in Ricardo's theory, labour is

considered homogenous, ruling out ownership advantage which is a major explanatory variable of FDI flows. Thirdly, the theory assumes complete international factor immobility which contradicts the nature of FDI as a movement of factors across national boundaries. Fourthly, the underlying assumptions of the theory are perfect competition and constant economies of scale. These propositions are, again, inconsistent with FDI which operates in oligopolistic markets and which activities are based on economies of scale.

In addition, Ricardo ignored several factors that were considered later by other economists as important FDI explanatory variables. Among these factors are the technological differences. Although he did refer to differences in productivity due to technology disparity among countries, he did not focus on the significance of this issue or its implications beyond labour productivity. This factor has been studied by Posner, Vernon (1979) and others and has formed the base for several FDI explanations.

Moreover, in Ricardo's theory, trade barriers and tariff cost are neglected. This issue was raised by Johnson in the late 1960s, who verified the neo-classical international trade theory and presented a dynamic form of the comparative advantage. He explicitly introduced transport costs, tariff and non-tariff barriers. He also referred to differences in taste and preference among countries shaped by cultural and political conditions, and how they represent an additional cost of acquiring information. Johnson's main contribution is quite evident in moving closer to the realities and dynamics of international trade and, besides which, he overlapped trade with FDI, particularly by introducing the importance of trade barriers which created a *raison d'être* for FDI (tariff-jumping investment). Accordingly, FDI and trade could be regarded as substitutes (Dunning, 1971; Hood & Young, 1979).

#### **2.9.4 Determinants of FDI**

The success of foreign investments depends on many variables; the success of investments in one market does not imply its success in other markets or its success at the same level. The principal factor is the variable environmental elements, which differ from one state to another. These variables could be divided into three main groups, linked by the basis and nature of the factors and the characteristics of the



country, which include each of the economic, political and legal factors, social and cultural elements, and variation in average individual income.

The rate of growth in national income, the habits and tastes of consumers, the attitudes of governments and population towards foreign investments all affect the degree of success of the company in a specific market; it does not only stop at such limits, it also affects generally the company's decision on foreign investment. Also, the successes of Multinational Companies depend on various elements:

1. The characteristics of the Multinational Company.
2. The advantages and obligations between the mother and host states and between the host states on the other side.

Companies might tend to decrease risks in the local markets through investing part of its financial and human resources overseas, or aim at acquiring raw materials through this investment. As to the objectives of the mother state, it frequently seeks the creation of employment opportunities abroad, opening up of new markets for exports, spreading its political and social culture in other countries, or attempting to exercise some sort of economic and political pressure to involve the host state in some sort of military or economic alliance. In regard to relative costs or the competitive advantages of the host country, it might be useful to present the international trade theory in this respect. The trade theory is based on the assumption that the state specialised in the production and marketing of commodities in which it has some competitive advantages as compared to other states. These specialisations enable the state to increase the expected benefits; such benefits might be in other products or in the form of protection for its resources (Robock & Simmonds, 1993).

In spite the logic of the assumption of the theory, it faced a lot of criticism, such as difficulties in explaining the reasons for the variation of the costs of production between different countries. Heckscher and Ohlin attempted to explain the causes of cost variations between states as result of the degree of availability of natural resources, in addition to the contribution of Stopler and Samuelson (Zied, 1981). However, Simmonds and Robock (1993) had significant reservations about the theory, which is summarised in the following points:

- The protection and opening of new foreign markets for a certain company could be achieved by other forms, excluding export through economic consortia, which not only eliminates barriers of trade but it also eliminates other forms of investment restrictions.
- International trade theory did not present other alternative activities for any company to carry out overseas.
- The theory ignored the technological level difference between the countries in the various economic aspects such as production, marketing and administration.
- Assuming some impractical factors, such as availability of information about investment opportunities in different countries and restrictions on the flow of factors of productions, it also overlooks monopolisation and it assumes perfect competition.

## **2.10 FDI THEORIES: CRITICAL ANALYSIS**

The above review of economic literature reveals that the firm theory contributes more than the international trade theory in explaining FDI.<sup>8</sup> Accordingly, FDI may be considered mostly an industrial phenomenon extending across national boundaries, rather than a trade one.

Being confined to the classical assumptions, the traditional international trade theories could not, in effect, contribute much in explaining FDI. The assumptions of perfect competition, economic environment and constant returns to scale are inconsistent with FDI in reality; particularly that market imperfection is a necessary precondition for FDI. Also, the assumption of complete international factor immobility rules out the existence of FDI. Moreover, with the exception of Linder's theory, the international trade theory focuses on the supply side in explaining the comparative advantage, ignoring demand's role, and assuming fixed preferences. Consumers' tastes and preferences shape consumption patterns and are effective in influencing trade and FDI (Todaro, 1994).

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<sup>8</sup> This assumes the FDI definition previously mentioned and implies that FDI could be regarded as an international firm-specific phenomenon.

However, the traditional theories provide the essence of international trade that is the comparative advantage concept, which is still applicable, though modified and elaborated to incorporate cultural, technological, and industrial factors, rather than just primary factors of production. In other words, the trade theories' contribution is mainly in presenting the comparative advantage as a base for trade.

Concerning the modern trade theories, although they did not refer to the phenomenon explicitly, they did introduce the basis for FDI explanation in their models. For example, Linder did refer to the role of demand, which was adopted later by Vernon in the product life cycle. Also, the imitation-gap theories focused on technology and R&D significance, thereby providing, once again, the basis for Vernon's theory. Finally, the monopolistic competition theory has been drawn on imperfect competition aspects such as product differentiation, economies of scale, and other features, all of which are quite relevant to FDI.

Alternatively put, the modern trade theories' main contribution to FDI analysis has been in approaching more closely the market structure in which FDI operates by emphasising common features of real world industrial structures. Also, these theories have implicitly clarified the relation between FDI and trade. Factor mobility (FDI) is a complement to intra-industry trade. In cases where factor mobility leads to similarity of factor endowments, FDI and intra-industry trade are motivated by economies of scale and product differentiation, whereas inter-industry trade may incorporate, like FDI, a real comparative advantage; in this respect, both could be considered as substitutes.

On the other hand, the firm theory did contribute more by providing different explanations for FDI. It has shown, although not intentionally, that FDI is motivated by several factors, not only due to comparative advantage. For instance, Hymer did present imperfections as the base for FDI but considered FDI to be a means of exploiting the monopolistic advantage acquired by the investing firm, through its control power. Also Vernon, through the product life cycle, showed how international country differences in technology and innovations could contribute to or motivate FDI. In addition, the internalisation approach considered FDI to be a means of

exploiting market imperfections by internalising advantages, i.e., bypassing the external market.

Thus, one could say that international trade theory did develop the basis of international production (comparative advantage reflecting cost minimisation), whereas the firm theory did provide various FDI explanations.

However, the firm theories have missed several factors influencing FDI. For example, all the motives or explanations presented reflected the perception of the home country with no attention paid to host countries' policies in establishing attractive factors, except Dunning, who referred to the locational advantage provided by the host country. They undermined the factors shaping the geographical pattern, although most of them referred to FDI movements among developed economies, due to similarity of per capita income and consumer tastes (Linder Vernon, 1979). They classified FDI as either market-driven, taking place among developed countries, or cost-driven, taking place between developed and developing countries (Vernon, 1979, Dunning, 1988).

Finally, no reference in the literature was made to the sectoral configuration of FDI. This issue is of great importance, especially today with the proliferation of the services sector, as FDI is the main conduit for services, and given the competitive advantage of TNCs in a world characterised by internationalisation of economic activities.

In fact, there exists a great need to develop a comprehensive international production theory, incorporating both FDI and trade. International production has been shaped by firms' strategies, which are no less important than trade relations. As noted above, most international trade theories did not explicitly refer to FDI. They viewed FDI and trade as substitutes, especially with the assumption of complete international factor immobility, which ruled out FDI and confined their attention to trade. Others considered FDI to substitute for inter-trade as long as factor earnings remained different. Among countries, FDI and intra-trade may be complementary as they are driven by the same factors (economies of scale and product differentiation). On the other hand, nearly all the firm theories considered both FDI and trade as different means of satisfying international demand, each taking place depending upon prevailing conditions and profitability expectations. For instance, Vernon considers

trade and FDI to be successive stages for servicing a foreign market. As a result, they were viewed for a long time as substitutes, particularly due to tariff jumping investment.

However, this claim is questionable as tariff jumping investment does not include all FDI. Also, FDI does not always take place merely to replace trade; the latter could be sometimes constrained, not only by tariffs, but by rising costs and currency appreciation, whereas it could be suitable for a foreign firm to invest.

In fact, FDI tends to appear as a complement to trade, rather than a substitute, taking into consideration that open economies enjoy a relatively large share of global trade and FDI flows, and that export-orientation is one of the major FDI determinants.

FDI does not displace a nation's exports, but rather stimulates them. It enables the firm to establish a larger distribution base and enlarge the line of products sold in a foreign market (sales, in this case, would be a combination of exports plus trade locally made) (Graham, 1997).

FDI and trade ought to be viewed as different means for exploiting and supplying a foreign market. In other words, the choice to be made is not between trade and FDI, but between FDI and losing share of the market.

## **2.11 THE LITERATURE REVIEW**

Generally it is noted that, since 1988, there has been very rapid growth in capital inflows to developing countries, and, since the early 1990s, there has been a significant shift in the composition of total capital flows to developing countries towards FDI and away from other flows, (Bosworth & Collins, 1999). Optimism about inflows of FDI to developing countries, especially Africa, derives from many observations. *Inter alia*, increased flows of FDI may enhance the savings gap of these countries and hence their GDP growth. The competition of incoming firms for location and market potentially could increase the opportunities for technological transfer. In addition, given the orientation of FDI towards tradeable sectors, this could expand export growth and hence ease the pressure on the balance of payments. Some of these gains are corroborated by empirical research. For instance, the results of

macroeconomic studies showed that FDI brings about a one to one increase in domestic investment thereby contributing to growth (Bosworth & Collins, 1999).

Moreover, Borensztein, De Grogorio and Lee (1995) found that a 1% point increase in the ratio of FDI to GDP in developing countries over the period 1971-89 was associated with a 0.4 to 0.7% point increase in the GDP per capita growth, with the impact varying positively with educational attainment as an indicator of a country's ability to absorb technology (Ajakaiye et al., 2009). Notwithstanding these gains, the experiences in Sub-Saharan Africa (SSA), and outside the region, indicate that FDI may incorporate inappropriate technology, the incoming firms may not integrate local firms in their network chains or may even eliminate such firms altogether. In particular, resource-seeking FDI could develop into export enclaves completely isolated from the domestic economy and may accelerate the depletion of these resources. More importantly, repatriation of profits could develop into serious balance of payments issues.

The empirical literature on the impact of FDI inflows on economic growth is very rich. Many studies have tried to assess the effectiveness of foreign capital on economic growth. The empirical literature has tried to assess if foreign capital reaches its main objectives, defined as the promotion of economic development and welfare of developing countries.

When focusing on the purposes of FDI on promotion of economic growth of developing countries, one note the results obtained, differ according to the approach used. The economic theory assumes that physical capital accumulation is the key to economic growth. However, advances in growth theory have come to show that the growth process relies on a complex set of interdependent factors.

The results obtained by these studies differ according to the approach and methodology used. The impact of foreign inflows on economic growth may be positive, negative or even non-existent, in statistical terms.

Ali Abdalla Ali, in his paper presented to an economic forum in Beirut, Lebanon (2001), pointed out that 'FDI is a type of inflows official and private, from one country to another, searching for higher return in host countries, which have political

and economic stability. It does not necessarily mean that it is the only determining factor of economic growth’.

FDI comprises activities that are controlled and organised by firms or groups of firms outside the nation in which they are headquartered and where their principal decision makers are located. FDI is characterised by the fact that it involves the purchase of fixed assets or the establishment of new production facilities, ‘Green Field Investment’. This character has changed over time. Mergers and acquisitions have become more prominent, implying that more foreign capital is being used to purchase assets rather than finance new investments.

Sandrina (2003) studied aid-growth relationship and evaluated the impact of foreign capital on growth in a cross country study during the period 1970-1998, in 2003. The study proposed methodological and economic procedures. It found that foreign inflows have a positive impact on economic growth. The study shows that the immediate and overall impact of aid on growth differ in terms of magnitude and type. Programme aid is expected to have a more rapid impact than project aid and this, in turn, is expected to have a more rapid impact than technical cooperation aimed at raising the level of human skills.

Durbarry et al. (1998) assess the impact of foreign capital on economic growth for a large sample of developing countries, by using an augmented Fischer-Easterly type model and estimate this using both cross section and panel data techniques.

The result strongly supports the view that foreign capital does have some positive impact on growth, conditional on a stable macroeconomic policy environment. The results vary according to income level, level of aid allocation and geographical location.

Hossain (1998) studied the relationship between foreign capital inflows and economic growth in Sudan during 1985-1994, and tried to assess to what extent Sudanese economics is affected by foreign capital inflows, by using a simple open macroeconomic model and focusing on the external balance of the economy. The study concludes that Sudan launched some development programmes which were

financed by external loans and grants and benefited from FDI and portfolio investment.

Elzubear (1993) in his study, examined the impact of foreign capital resources on economic development. The capital included in his study are long term concessional loans, grants, private foreign capital and FDI. The data was obtained from the Ministry of Finance and the Bank of Sudan. The two gap approach model is used. According to him, the weak external sector performance has been the major impediment to growth and development. It has been mainly due to the heavy dependence on a single crop (cotton) and structural rigidities in the agricultural sector have limited the possibilities of diversification of exports. Moreover, dependence on imported capital goods, raw materials and other vital inputs needed for agriculture which are not produced domestically made it difficult to reduce imports without adversely affecting domestic production.

The study concludes that foreign capital did contribute to the growth process in Sudan by financing higher levels of public sector investment than would otherwise have been possible, particularly at a time when onward external shocks caused continuous and severe foreign exchange scarcity. The high level of investment made possible by foreign aid resources has contributed significantly to the development of the major sectors of the economy and raised the overall output growth rates.

Mutasim (2005) investigates, from an empirical point of view, the impact of Sudan's external indebtedness on economic growth over the period 1978-2001. In addition to that, the growth rate of real export earnings is included in the empirical model to capture the impact of export promotion strategy in inducing economic growth, while inflation rate is incorporated as a macroeconomic policy variable.

The results of the study reveal the existence of the debt overhang problem in Sudan, i.e., external debts exceed the country's repayment ability. The study concluded that external debt and inflation deter economic growth, while export earnings have positive impacts. Thus, the findings of this study support the need of Sudan to be considered for comprehensive debt relief measures. The study recommends the adoption of an export-led growth strategy besides improving infrastructure. Furthermore, encouraging domestic saving and realising peace in a united Sudan will



help restore debt sustainability and the study recommends further studies to promote FDI.

## **2.12 LITERATURE REVIEW OF CHINESE INVESTMENT IN SUDAN**

Recently, China's economic influence globally has increased in terms of trade level, investments made and loans provided. In particular, China's DFI has risen remarkably following the 'go-out' strategy. These developments have spurred considerable interest and concern about the motivations and the implications of the increasing Chinese outward presence, especially in Africa. There has been much discussion in popular media and, more recently, in scientific literature about the evolving engagement of China with Africa. Some of the research appeared in special journals issues, notably the *European Journal of Development Research*, Vol. 21 Issue 4, 2009, *World Development*, Vol. 36 No. 2, 2008, and the *Review of African Political Economy*, Vol. 35, No. 1, 2008. Africa-based research on the China–Africa relationship appeared on scoping studies of 18 countries and was further developed into a second stage of 22 more detailed country case studies.

The key results from the scoping studies show that, although China's FDI to Africa is small, it is increasing over time. The distribution of these investments is rather geographically dispersed, yet five countries (Angola, Nigeria, South African, Sudan and Zambia) accounted for more than half of the FDI stock in 2005. It is also reflected in these studies that China's FDI is attracted to specific sectors mostly oil and minerals, physical infrastructures, agriculture, manufacturing, services and retail trade. Oil, minerals and physical infrastructure were the main sectors targeted by China's investment in SSA (Ajakaiye, 2009).

The central policy issue facing SSA, including Sudan, is how to maximise the gains from the upsurge in China investments, which provide a window for finance and technological transfers, while addressing the potential and possible challenges. Kaplinsky and Morris (2009) suggested unpacking the streams of these FDIs, and the use of a micro-oriented approach to focus more on the behaviours of the investing firms to improve our understanding of the source of gains and challenges presented, and what policy can do. By placing China's investment in Africa in its historical context, four types of investors were identified: central-state-owned firms, provincial-

state-owned firms, Chinese private firms incorporated in China, and small firms operating in Africa owned by Chinese 'migrants'. Each type of investor has its own characteristics, but the first two, government firms as the first movers, were differentiated from their western counterparts by being closely and strategically bundled with aid and trade links. The authors suggest that the SSA countries can benefit by developing a strategy of integrating aid, trade and FDI vectors similar to that which is being pursued clearly by the Chinese government's firm. However, this needs to be coordinated informally and bilaterally between the concerned governments.

The Chinese private sector FDI, the second movers, as well as Chinese immigrant investors are relatively under-researched. One reason may be that, private firms were recognised in China for the first time in 1982 as supplementing entities to government's firm, but such an ownership form was only properly defined in 1988, was acknowledged to be an integral part of the Chinese economy in 1997 and had its legal status strengthened in 1999 (Voss et al. 2008). Chinese immigration has a long history, however, recently interest has developed in the role of those migrants as the trading hubs of China's trade access into the global economy. Gu (2009) studied the private FDI of firms incorporated in China, the analysis is based on interviews in both China and Africa with Chinese entrepreneurs and African policy-makers.

Eight provinces and regions in China and in Ghana, Nigeria and Madagascar were surveyed. The results of the study reveal that the number of China-incorporated firms which have established operations in SSA is substantial. The official records quite underestimate the number of these firms. It is also shown that many of the Chinese investors are drawn to Africa by intense competition at home, and that contrary to much of the current conventional wisdom, the Chinese state offers little support to these private investors. Kragelund (2009) compiled data from various sources to review the trend of China's investments in Zambia; the results showed that by 2006, China had become the largest foreign investor in Zambia, with 184 documented investments. It was also found that these investments diversify away from resource-seeking; the Chinese investors were mostly attracted into manufacturing followed by services and construction. In the same vein, and contrary to the view that China's FDI may indirectly hurt Africa's manufacturing sector, the Ancharaz (2009) study of the

Mauritian case explains the resilience, in particular, of the clothing and textile industry in the face of China's challenges. It was shown that the prudent government policies, in collaboration with the private sector, help to mitigate the impact of the Chinese firms investing in the Mauritian export processing zones (predominantly in clothing). Mauritius also gains from Chinese aid in construction and infrastructure.

Mohan (2009) highlighted the trends of the fourth type of China's investors in Kaplinsky and Morris's taxonomy. The study showed that, although the Chinese migrants in Africa have a long history they remain scattered, except in countries such as South Africa and Mauritius. However, post 1990s, this diaspora increasingly plays a role in facilitating FDI by private sector and provincial State Owned Enterprises (SOEs) through networking.

China's investments in Sudan generate heated debate in popular and specialist literature alike. Much of the discussion was triggered by the operations of China's firms in the country's oil sector, which was abandoned by their Western counterparts. The optimists draw on the case of Sudan to point that China's deal of combining FDI, non-interference and aid not tied to political situation, provides an alternative 'new developing model' for African countries to choose. In contrast, others argued that such a deal is problematic, it has led to irrational governance and deterioration of transparency in Sudan (Sahu, 2008). Before securing peace in 2005, the argument was that China's FDI exacerbated the Southern conflict and caused displacement of civilians (Patey, 2006; and Crisis Group, 2008). Recently, the Darfur conflict is linked to these investments (Crilly, 2005).

The subsequent chapters of this study show that production of oil as such is not a source of violence or corruption, but politicisation of oil is the main reason driving these problems. Outside oil, there is a noticeable increase in the number of private Chinese firms, with great potential for contribution in import-substitution and hence improving competitiveness in the industrial sector.

## **2.13 LITERATURE REVIEW OF THE RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH**

During the last decades, the relation between FDI and economic growth has been extensively discussed in the economic literature. Theories and existing literature provide conflicting results concerning this relationship. On one hand, some scholars argue that foreign direct investment could stimulate technological change through the adoption of foreign technology, know-how and technological spillovers, thus boosting host country economies. On the other hand, other pessimists believe that FDI may bring about a crowding out effect on domestic investment, external vulnerability and dependence, destructive competition of foreign affiliates with domestic firms and ‘market-stealing effect’ as a result of poor absorptive capacity.

In literature, there exists an agreed framework definition of FDI. That is, foreign direct investment is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency (World Bank, 1996). FDI can be divided into two forms: ‘greenfield’ investment, which is also called ‘mortar and brick’ investment, as well as merger and acquisition (M&A), which entails the acquisition of existing interest rather than new investment.

In corporate governance, a direct investment relationship is established when at least 10% of the ordinary shares or voting stock is owned. Ownership of less than 10% is regarded as portfolio investment. Besides greenfield investment and M&A, reinvesting earnings and loans and similar capital transfer between parent companies and their subsidiaries also belong to foreign direct investment. Countries could be both host to FDI projects in their own country and a participant in investment projects in other countries. A country’s inward FDI position is made up of the hosted FDI projects, while outward FDI comprises those investment projects owned abroad.

An important aspect of globalisation during the last few years has been the impressive surge of FDI by multinational corporations, which have become the primary source of external financing for countries all over the world. During the past few years, the role of FDI has become more and more important for developing countries and less developed countries. Indeed, it increased rapidly during the late 1980s and the 1990s.

According to the UNCTAD database, FDI flows to less developed countries have multiplied by seven between 1991 and 2000, while the stock of FDI multiplied by five. The inward FDI flows to less developed countries considered as a whole increased again by 52% between 2001 and 2005, as Figure 1 illustrates. Such high growth is unprecedented.

According to the World Bank (2007), global FDI flows reached a record of US\$ 1.1 trillion in 2006 and there has been a continuing rise in FDI inflows to developing countries. In recent years, FDI outflows from large developing countries are also on the rise. For example, since 2004, FDI flows from India into the United Kingdom have exceeded flows from the United Kingdom to India. This evolution and changing patterns in world FDI flows has been synchronous with a shift in emphasis among policymakers in developing countries to attract more FDI (through tax incentives and subsidies to foreign investors). Nowadays, the total FDI stock represents more than 20% of global GDP. The rapid growth of FDI and its overall magnitude sparked numerous studies dealing with the relationship between FDI and economic growth. While the explosion of FDI is unmistakable, the growth effects of FDI still remain controversial, both theoretically and empirically.

Over the last decades, the relation between FDI and economic growth has been extensively discussed in the economic literature. The positions range from an unreserved optimistic view (based on the neo-classical theory or, more recently, on the new theory of economic growth) to a systematic pessimism (namely among 'radical' economists). There is a widespread belief among researchers and policymakers that FDI boosts growth for host countries through different channels. They increase the capital stock and employment; stimulate technological change through the adoption of foreign technology, know-how and technological spillovers, which can happen via licensing agreements, imitation, employee training, and the introduction of new processes, and products by foreign firms. As it eases the transfer of technology, FDI is expected to increase and improve the existing stock of knowledge in the recipient economy through labour training, skill acquisition and diffusion. It contributes to introducing new management practices and a more efficient organisation of the production process. As a consequence, FDI can play an

important role in modernising a national economy and promoting economic development.

Starting with the pioneering work of Caves (1974), his country case studies and industry level cross sectional studies led him to conclude that there exists a positive correlation between the productivity of a multinational enterprise (MNE) and average value added per worker of the domestic firms within the same sector. Later, in 1996, Caves observed several positive effects of FDI that brought about increasing efforts to attract more of it. Among these were productivity gains, technology transfers, the introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks and access to markets. Findlay (1978) has postulated that FDI, through a 'contagion' effect, increased the rate of technical progress in a host country from the more advanced technology, management practices, etc., used by foreign firms. In addition, FDI may contribute to economic growth where the transfer of technology raised the stock of knowledge in host country through labour training and skill acquisition, new management practices and organisational arrangements (De Mello, 1999). Borensztein et al. (1998) pointed out that FDI, an important vehicle for the transfer of technology, has contributed to growth in larger measure than domestic investment. According to Rappaport (2000), FDI may improve the productivity not only of the firms receiving investments, but also of all firms of the host countries as a consequence of technological spillovers. These spillover effects were generated from both intra-industry (or horizontal, i.e., within the same sector) externalities and inter-industries (or vertical) externalities through forward and/or backward linkages (Javorcik, 2004; Alfaro & Rodriguez-Clare, 2004). De Gregorio (2003) has noted that technologies and knowledge that are not readily available to host country investors may be brought to them along with FDI, and in this way, lead to productivity growth throughout the economies. FDI may also bring in expertise that the country does not possess, and foreign investors may have access to global markets. In fact, through empirical studies, he found that increasing aggregate investment by one percentage point of GDP increased economic growth of Latin American countries by 0.1% to 0.2% a year, but increasing FDI by the same amount increased growth by approximately 0.6% a year during the period 1950–1985, thus indicating that FDI is three times more efficient than domestic

investment. Furthermore, the advocates of FDI have argued that FDI could help promote economic growth through technology diffusion and human capital development (Van Loo, 1977; Borensztein, De Gregorio and Lee, 1998; de Mello, 1999; Shan, 2002a; Liu, Burridge & Sinclair, 2002; and Kim & Seo, 2003). When multinational corporations have vertical inter-firm linkages with domestic firms or have sub-regional clusters of inter-related activities, through formal or informal links or social contacts among the employees, they could diffuse technology and management know-how to local firms. Moreover, as Noorzoy put forward in 1979, FDI could help host countries overcome capital shortage and complement domestic investment when FDI flowed to high risk areas or new industries where domestic investment is limited. When FDI is attracted for resource industries, for instance petroleum, domestic investment in related industries may be stimulated. Also, FDI may boost exports for the host countries.

Empirical studies supporting these arguments include Sun (1998) and Shan (2002). Using the conventional regression model and panel data, Sun (1998) found out a high and significantly positive correlation between FDI and domestic investment in China. Shan (2002) have used a VAR model to examine the inter-relationships between FDI, industrial output growth and other variables in China. He has concluded that FDI has a dramatically beneficial impact on the Chinese economy when the ratio of FDI to industrial output rose. Nevertheless, some macroeconomic studies, using aggregate FDI flows for a broad cross section of countries, generally have suggested a positive role for FDI in generating economic growth in particular environments. For instance, Blomstrom, Lipsey, and Zejan (1994) believed that FDI had a positive growth effect when the country was sufficiently wealthy, that is, FDI could exert a positive effect on economic growth, but that there seemed to be a threshold level of income above which FDI had positive effect on economic growth and below which it did not. This was because only those countries that had reached a certain income level could absorb new technologies and thus benefit from technology diffusion, reaping the extra advantages that FDI could offer. Besides, Alfaro et al. (2003) has argued that FDI promoted economic growth in economies with sufficiently developed financial markets, while Balasubramanyam, Salisu, and Sapsford (1996) have stressed that trade openness was crucial for obtaining the growth effects of FDI.

However, the positive effects of FDI on economic growth have not won unanimous support recently. This pessimist view, having risen during the 1950s and the 1960s, is still now defended by several recent firm or industry level studies which emphasise poor absorptive capacity, crowding out effect on domestic investment, external vulnerability and dependence, a possible deterioration of the balance of payments as profits are repatriated and negative, destructive competition of foreign affiliates with domestic firms, and the 'market-stealing effect'.

In an influential study, Aitken and Harrison (1999) did not find any evidence of a beneficial spillover effect from foreign firms and domestic ones in Venezuela over the 1979-1989 period. Similarly, Haddad and Harrison (1993) and Mansfield and Romeo (1980) found no positive effect of FDI on the rate of economic growth in developing countries, namely in Morocco. As De Mello (1999) has pointed out: 'whether FDI can be deemed to be a catalyst for output growth, capital accumulation, and technological progress seems to be a less controversial hypothesis in theory than in practice'. Moreover, Lipsey (2002), after surveying the macro empirical research, claimed that a consistent relation between the size of inward FDI stocks or flows relative to GDP and growth did not exist. He further argued that there was need for more consideration of the different circumstances that obstructed or promoted spillovers. Later, Lipsey and Sjöholm summarised that evidence of positive spillovers of FDI had been found by researchers in some countries and some industries, though country-specific and industry-specific factors seemed so crucial that these results did not support the overall conclusion that FDI brought about substantial spillover effects for the entire economy.

In addition, the industrial organisation theory brought forth by Hymer (1960) and Caves (1971) has stipulated that FDI is an aggressive global strategy by MNEs to advance monopoly power over and above indigenous firms of the host economy. The particular advantages of multinational corporations (such as advanced technologies, management know-how skills, transaction cost minimising and other intangible advantages) could be transformed into monopoly power, which could be further strengthened by the other two advantages of multinational corporations: the market internalisation advantage and the location-specific advantage (Dunning, 1981). For instance, multinational corporations could control supplies of inputs in an industry in



the host country and gain the benefits of a tax subsidy provided by the host government. This may strengthen the competitive advantages of MNEs over domestic firms. Eventually, domestic firms will be forced to exit. Empirical studies backing up those views could be found in Braunstein and Epstein (2002) and Huang (2003). Using a regression model with province-level panel data from 1986 to 1999, Braunstein and Epstein found that FDI had crowded out domestic investment in China. They pointed out that the benefits of FDI had almost disappeared as a result of intense competition for FDI among the regions in China, which has forced regions to reduce taxes, regulations on environmental protection, wages and working conditions. Moreover, as Huang (1998, 2003) pointed out, with Chinese investment policies being more friendly to foreign invested enterprises than to domestic firms, Chinese partners were eager to form foreign invested enterprises with foreign investors. Having exploited the preferential policies and even possessed privileges in competing for local scarce resources, these joint ventures eventually crowded out domestic investment.

Furthermore, the influence of particular environments on the growth effect of FDI has been questioned. As discussed above, Blomstrom et al. (1994) has showed that a positive growth effect of FDI may be real when the country was sufficiently rich. However, Carkovic and Levine (2002) have rejected this finding, taking account of an interaction term from income per capita and FDI. Alfaro et al. (2007) suggested that FDI had a positive growth effect in countries with sufficiently developed financial markets. According to Carkovic and Levine (2002), this view was not true since FDI flows did not exert an exogenous impact on growth in financially developed economies. Finally, Balasubramanyam et al. (1996) contended that trade openness is very important in order to obtain the growth effect of FDI, which was defended by Kawai (1994). Carkovic and Levine (2002) also have challenged this standpoint. Generally, the existing literature has provided conflicting predictions concerning the growth effects of FDI. Scholars supporting the positive effects of FDI on economic growth believe that it could stimulate technological change through the adoption of foreign technology and know-how and technological spillovers, thus modernising the host country's economy.

Opponents hold that FDI may bring about a crowding out effect on domestic investment, external vulnerability and dependence, destructive competition of foreign affiliates with domestic firms and a 'market-stealing effect' as a result of poor absorptive capacity. These findings must be viewed sceptically, however, because existing studies did not fully control for simulative bias, country-specific effects or industry-specific effects. The routine use of lagged dependent variables in growth regressions also is a problem. These weaknesses can bias the coefficient estimates, as dependent variables in growth regressions also is a problem. These weaknesses can bias the coefficient estimates as well as the coefficient standard errors. Thus, it is necessary to reassess the present evidence with econometric procedures that eliminate these potential biases.

## **2.14 CONCLUSION**

This chapter is mainly concerned with clarifying FDI as a phenomenon different from capital flows, portfolio investment and TNCs. It identifies FDI as a unique/special phenomenon related to international production, revealing its significance, magnitude and direction.

As discussed, FDI has been a major phenomenon that is shaping the new world order. It has been a driving force in world trade that controls cross-border transactions, thereby changing the global map of production and trade. It has strengthened the international integration of domestic markets. FDI has been partly responsible for the increasing geographical extent and complexities of TNC activities, as well as the intensified competition throughout the world economy. Over the past few decades, FDI has recorded high growth rates, exceeding that of both world trade and GDP, and is anticipated to continue this rapid growth in the foreseeable future, as more and more countries are opening up their economies and liberalising their trade as well as investment regimes.

As for FDI and TNCs, FDI could be regarded as a movement of capital, tangible and intangible resources that embrace, in addition to TNCs, other forms of activities, such as joint ventures and non-equity arrangements (e.g., licensing, management contracts). However, both terms, FDI and TNCs, are used interchangeably, since TNCs are the main vehicle by which FDI is transferred all over the world.

The present chapter attempts to assess the contribution of economic literature to FDI explanation. The review of the economic literature has been beneficial in explaining FDI. Thus, one could say that international trade theory did develop the basis of international production (comparative advantage reflecting cost minimisation), whereas the firm theory did provide various FDI explanations.

This chapter sums up the literature as well as empirical studies on the relationship between foreign direct investment and economic growth, trying to arrive at a meaning revelation eventually. During the last decades, the relation between FDI and economic growth has been extensively discussed in the economic literature. The positions range from an unreserved optimistic view (based on the neo-classical theory or, more recently, on the new theory of economic growth) to a systematic pessimism (namely among ‘radical’ economists). There is a widespread belief among researchers and policymakers that FDI boosts growth for host countries through different channels.

## **Chapter 3**

# **FOREIGN DIRECT INVESTMENT: EMPIRICAL EVIDENCE**

### **3.1 INTRODUCTION**

As elaborated in the previous chapter, the literature review has clarified different home countries' motives for undertaking FDI. Foreign firms are driven to invest across national boundaries, in order to exploit an advantage, gain access to a foreign market, overcome uncertainty and compete internationally.

Little attention has been paid, however, to host countries' attractive investment conditions and their impact on the FDI locational decision. The theory has illustrated, in effect, the necessary conditions for undertaking FDI in the first place, but has ignored, to a large extent, the analysis of conditions in host countries which affect the direction of foreign investment towards certain areas.

Admittedly, some theories did partially refer to FDI's spatial distribution. For example, in Linder's theory, FDI takes place among developed economies as a result of income and taste similarity. Another interpretation was presented by Vernon in his product life cycle theory where, in later stages, FDI moved from developed to developing countries, seeking cost minimisation. Also, Dunning referred in his OLI paradigm to the host economies' role in terms of locational advantage, which is considered one of the specific advantages for FDI explanation.

Despite these theoretical attempts, FDI geographical distribution has been mainly analysed in the light of home countries' motives. The main concern of the present chapter is to explore fundamental factors determining FDI's locational distribution. It displays the spatial pattern of FDI inflows, and outlines the findings of some empirical studies concerning the phenomenon's spatial distribution. It also sheds light on some policy implications with special emphasis on developing countries. The chapter discusses the effect of international economic evolution on the flow of FDI, and the positive and negative effects of these investments.

Chapter Three includes FDI geographical distribution and empirical studies.

## **3.2 FDI GEOGRAPHICAL DISTRIBUTION**

High concentration is the main feature of FDI's geographical distribution. Firstly, FDI inflows are highly concentrated in developed countries. Secondly, within the developing economies, FDI is greatly concentrated in certain regions and countries.

### **3.2.1 FDI Spatial Distribution**

Although the developed economies' share of world FDI fell during the 1990s to around 60% (compared with 82% in the period 1987-1991), they still account for a sizable share of FDI inflows, implying relative concentration in favour of developed countries. On the other hand, developing countries have recently managed to attract more foreign investors. Since 1987, they have achieved high rates of growth of FDI inflows<sup>9</sup> compared with developed countries and gained, as a result, a growing share of FDI inflows. Their share has risen from about 18% in the second half of the 1980s to about 35% in the first half of the 1990s. In 1994, the developing countries accounted for about 25% of total FDI stock as outlined in Table 3.1.<sup>10</sup>

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<sup>9</sup> This chapter includes only FDI inflows rather than inflows and outflows, since the focus here is on the geographical pattern and the host countries' attracting factors and not on home country motives which are mainly responsible for FDI outflows.

<sup>10</sup> The share of developing economies in FDI outflows is around 13% for the period (1992-1994) (UNCTAD, 1995).

**Table 3.1: FDI Inflows US\$ billion, 1990-2010**

Year	Developed countries			Developing countries		
	Inflows	Share (%)	Growth rate	Inflows	Share (%)	Growth rate (%)
1990	172	83		35	16.9	
1994	150	58.5	-3.2	103	40.2	48.5
2000	1,137	81.2	109	255	18.2	24.5
2006	981	67.1	-2.3	427	29.1	45
2010	618	47.2	-9.25	616	47	11

*Source:* UNCTAD, Division on Transnational Corporations and Investment, based on IMF balance of payments tape, retrieved in June 1995, and data from the Organization for Economic Co-operation and Development (OECD) Secretariat. Calculated on the basis of FDI flows expressed in US\$ million (UNCTAD, 1995: 14; UNCTAD, 2011).

In addition, the share of inward FDI stock to GDP has increased in developing countries, a fact which might reflect the importance of FDI in accelerating growth in these economies (Table 3.2).

**Table 3.2: Share of Inward FDI Stock in GDP, Selected Years**

Year	1980	1985	1990	1994
Developing countries	4.3	7.7	8.3	12.5
Developed countries	4.8	6.0	8.4	8.6

*Source:* UNCTAD, based on the division's FDI database and data provided by UNCTAD Secretariat (UNCTAD, 1996: 261 & 262).

Moreover, it is worth noting that the developing countries' share of world FDI is nearly one-third, almost equal to their contribution to world trade, and exceeding their share in world GDP (around one-fifth). As a result, one could claim that developing economies do receive a reasonable share of FDI, especially if compared with both their corresponding shares of both world trade and global GDP (Table 3.3).

**Table 3.3: World FDI, Trade, and GDP, 1994**

<b>Item</b>	<b>Developing countries</b>	<b>Developed countries</b>
FDI	40	60
Share of merchandise exports to world exports	40	60
Share of merchandise imports to world imports	22.3	77.7
Merchandise trade as a % of world trade	32.3	67.7
Share of world GDP	205	79.5

*Source:* World Bank 1995a and 1996b

However, this macro picture could mask important insights, given FDI's high concentration and uneven distribution in developing economies. These present patterns of spatial allocation reveal that developing countries as a whole are gaining a share of world FDI inconsistent with their needs and potential, and that there exist marginalised countries which are deprived of FDI benefits. Therefore, it is of paramount importance to undertake a thorough analysis of FDI's distribution within developing economies.

### **3.2.2 FDI Distribution among Developing Countries**

This section deals with FDI inflows distribution in developing economies, which reveals a relatively high degree of concentration within regions and countries.

#### **a- Concentration among regions**

According to Table 3.4, East Asian and Latin American regions attract most FDI inflows. In 1995, about 72% of net FDI inflows were directed towards those regions, leaving a minority share for sub-Saharan Africa, the Middle East and North Africa.

**Table 3.4: Net FDI Inflows by US\$ Billion, and Annual Average Growth by Percentage in Developing Countries, by Region, 2007–2010**

Country	FDI inflows				Average growth
Year	2007	2008	2009	2010	-
World	2,100	1,744	1,185	1,244	-
Developing Countries	585	658	511	574	12.3
Africa	63	73	60	55	20.4
Latin America and the Caribbean	164	207	141	159	32.1
West Asia	78	92	66	58	19.6
South, East and South East Asia	259	284	241	300	69.3
South East Europe and CIS	91	121	72	68	0.55

*Source:* UNCTAD World Investment Report 2011

This large share may be attributed to several factors: (i) The rapid economic growth during 1991-1995, reaching 8% growth in real GDP per capita (compared with only 2.6% in aggregate GDP per capita of all developing countries);<sup>11</sup> (ii) The agreement reached by the Asia-Pacific Economic Co-operation Forum's Ministerial meeting (11-12 November 1994), aimed at achieving open trade and investment in Asia Pacific no later than 2010, which has been responsible for improving the investment climate within the region; and (iii) The large and growing domestic market, and the inclusion of countries enjoying location-specific advantage which enabled the region to trigger sustainable and diversified types of FDI (UNCTAD, 1995).

Latin America and the Caribbean is the second largest FDI recipient region accounting for 23% of FDI inflows to developing countries, during 1993-95 (World Bank, 1996a).<sup>12</sup> This relatively large share of FDI could be attributed to: (i) an improved macroeconomic environment, revealed by real per capita GDP growth (1.1% compared with 1.2% in high-income countries during 1991-95), and the fall in the foreign debt service from around US\$ 38.6 billion in 1985 to US\$ 27.5 billion in 1994 (World Bank, 1996a); (ii) increasing waves of privatisation, which have raised

<sup>11</sup> Excluding Eastern Europe and the former Soviet Union in the first three years of the 1990s.

<sup>12</sup> Latin America and the Caribbean region tops developing countries if China is excluded from East Asia.



almost US\$ 17 billion in foreign exchange between 1988 and 1993 compared with just US\$ 5 billion in East Asia (World Bank, 1995a), and (iii) investment restrictions relaxation, particularly in natural resources and infrastructure industries.<sup>13</sup>

### **b- Concentration among Countries**

As among regions, FDI concentration also applies at country level. During 1989-1995, about 75% of FDI flows to developing countries were confined to only ten countries (Todaro, 1996). In 1991, the top ten countries accounted for around 66.7% as shown in Table 3.5.

**Table 3.5: Major Destinations of FDI to Developing Countries, 1991**

<b>Recipient country</b>	<b>US\$ million</b>	<b>Percentage</b>
Mexico	4,762	13.3
China	4,366	12.2
Brazil	1,600	4.5
Malaysia	3,455	9.6
Argentina	2,439	6.8
Thailand	2,014	5.6
Indonesia	1,482	4.1
Korea, Republic of	1,116	3.1
Venezuela	1,914	5.3
Turkey	810	2.2
Top ten countries	23,958	66.7
Others	11,937	33.3
Developing countries	35,895	100

*Source:* IMF Balance of Payments Yearbook and World Bank (World Bank, 1993: 29)

Note: FDI based on net inflows, balance of payments basis.

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<sup>13</sup> For example, Argentina in 1992 allowed FDI in the privatisation of the State Gas Company and Mexico in 1995 opened land transportation of both passengers and cargo to FDI.

However, this apparent concentration is less acute when scaling FDI by recipient GDP or Gross Domestic Income (GDI). GDI/GDP in the top recipient countries were somewhat closer to the average of all developing countries (1.1% and 4.5% respectively). Exceptions were Argentina, Malaysia and Venezuela, with high FDI-GDI ratios, and Malaysia with a high FDI-GDP ratio (World Bank, 1993) as outlined in Table 3.6.

**Table 3.6: FDI Ratios in Major Recipient Developing Countries, 1991**

<b>Recipient country</b>	<b>Share of recipient GDP (%)</b>	<b>Share of recipient GDI (%)</b>
Mexico	1.7	7.4
China	1.2	3.3
Brazil	0.4	2.0
Malaysia	7.4	20.5
Argentina	1.9	15.1
Thailand	2.2	5.6
Indonesia	1.3	3.6
Korea, Republic of	0.4	1.0
Venezuela	3.6	19.2
Turkey	0.8	3.9
Developing countries	1.1	4.5

*Source:* IMF Balance of Payments Yearbook and World Bank estimates (World Bank, 1993)

Note: FDI based on net inflows, balance of payments basis.

Concerning FDI distribution within East Asia and the Pacific region, China is the major recipient country, accounting for around 74% of inflows to the region during 1993-95. In fact, it represents a unique example as it is one of the fastest growing economies in the world. During 1991-1995, China achieved an outstanding growth performance, recording an average annual GDP growth rate of 12%. FDI inflows increased by nearly tenfold from just US\$ 4.4 billion to US\$ 37.5 billion throughout

the same period (UNCTAD, 1996). This concentration is still prevalent, even after excluding China, as Malaysia and Indonesia account together for about 70% of total FDI inflows to the region (Table 3.6). Malaysia's share of FDI inflows tripled from 1990 to 1995, ranking second after China. FDI in Indonesia has also experienced a fourfold increase during the same period.<sup>14</sup>

In addition, FDI distribution within Latin America and the Caribbean region reflects high spatial concentration. Between 1988 and 1994, Argentina and Mexico accounted together for about 60-70% of total inflows to the region (UNCTAD, 1995). At the beginning of the 1990s, Argentina's share more than tripled from US\$ 2.4 billion to US\$ 6 billion between 1991-1993, thus representing the largest FDI recipient in the region (and the second largest among developing countries). Its share constituted, on average, about 39% of total investment directed to the region (World Bank, 1994/95).

Concerning Mexico, its share rose from about 32% of FDI inflows to the region in 1988 to 40% in 1994. FDI inflows more than doubled between 1989 and 1994 (World Bank, 1994/95, 1996a).<sup>15</sup> In 1995, inflows fell, however, by about 50% to about US\$ 4.1 billion. This decline could be explained by the uncertainty following the peso-crises, which began in November 1994 and exerted a negative impact on the country's economic growth and stability (Table 3.7).

**Table 3.7: FDI Flows in Latin America and the Caribbean, 1990-1995**

Country	1990	1991	1992	1993	1994	1995	Annual growth rate
Mexico	2.6	4.8	4.9	4.9	8.0	4.1	3.9
Argentina	1.8	2.4	4.2	6.3	1.2	4.0	2.6
Brazil	0.9	0.9	1.6	0.8	2.2	-	1.5
Chile	0.6	0.6	0.7	0.9	1.8	-	1.1
Colombia	0.5	0.6	0.8	0.9	1.5	-	0.7

<sup>14</sup> Its share increased from around US\$ 0.4 billion in 1987 to US\$ 2.3 billion in 1990, then it nearly tripled reaching US\$ 5.8 billion in 1995.

<sup>15</sup> It increased from US\$ 3 billion to nearly US\$ 5 billion between 1988/90-1993 and hit a record of around US\$ 8 billion in 1994.

Country	1990	1991	1992	1993	1994	1995	Annual growth rate
Venezuela	0.4	1.9	0.7	0.4	0.9	-	0.7
Peru	0.04	-0.007	0.1	0.3	2.7	-	0.5
Others	0.97	1.1	1.2	1.5	2.0	-	-
Total	7.8	12.3	14.2	16	20.3	-	12.1

*Source:* UNCTAD, Division on transactional corporations and investment, based on ECLAC/UNCTAD 1995b; and UNCTAD-DTCI, FDI database (UNCTAD, 1995: 71)

According to the previous review, the FDI geographical distribution has revealed a high degree of concentration, both at the region and country level, thereby highlighting the need for most economies for substantial FDI inflows, particularly to support and strengthen their economic reform schemes currently adopted.

In this context, it becomes essential to examine the factors that influence foreign investors' locational decisions, and hence recipient countries. The following section sheds light on this issue by reviewing the results of some empirical studies, relating to factors determining FDI locational decisions.

### **3.3 EMPIRICAL STUDIES**

#### **3.3.1 Factors Determining FDI Spatial Distribution**

Several empirical studies have been concerned with the main factors shaping FDI's geographical configuration. Their findings have provided supporting evidence to FDI theoretical foundations, adding other complementary factors.

Most empirical cases have highlighted the declining importance of incentives as a decisive factor for investment.<sup>16</sup> In the past, host countries (mainly developing) heavily relied on investment incentives<sup>17</sup> to attract FDI, particularly if production is

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<sup>16</sup> Investment incentives are broadly defined as government measures to influence the size, location or industry of an investment by affecting its relative cost, potential profits, or by reducing risk. Generally, they aim at improving conditions for investors.

<sup>17</sup> The most typical fiscal incentives include exemptions from import duties, duty draw backs and generous tax holidays (five to ten years or even extending to 25 years in some cases).

oriented towards domestic markets (UNCTAD, 1994). Helleiner (1988) claimed that investment incentives appear to play a limited role in inter-country investment decisions, particularly if these incentives are to compensate for a comparative disadvantage. Investment incentives<sup>18</sup> are considered costly and inefficient and are only viewed as complementary factors triggering FDI (Bond Chiu & Estache, 1995; UNCTAD, 1995).

On the other hand, empirical studies emphasise other critical factors as being responsible for FDI geographical pattern. Among these are market size and potential growth, business operating conditions, and governance, which are discussed below.

### **Market Size and Potential Growth**

Market size, as well as potential growth, has been considered one of the most significant factors affecting the location decision of foreign investment. Evidence has shown how large economies have succeeded in attracting the bulk of FDI, due to high potential for local sales and the existence of diversified resources (Meier, 1995).

Empirical studies have found the estimated coefficient of GDP as a proxy for a host country's market size to be statistically significant and reflecting a strong positive correlation. In addition to that, the larger the current or expected market size, the more FDI flows to the target country. The market growth index also confirmed the same positive relationship.<sup>19</sup>

China is considered the best example to cite. Between 1991 and 1996, FDI inflows increased more than tenfold and, by 1996, the country captured around 38% of total flows to developing economies. This is largely attributed to its vast market and sustained level of economic growth (World Economic Forum, 1997). Also, Indonesia's success in tapping FDI is partly due to its development strategy, based on macroeconomic stability and high rates of growth, reaching about 8.1% in 1995 (World Bank, 1996c). Argentina is another example. The country's success in

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<sup>18</sup> It is claimed that incentives could increase distortion in the production system similar to those caused by trade distortions.

<sup>19</sup> A composite index that summarises not only quality of institutions, economic policies and the degree of openness as the various factors that matter for long-term growth, but it is also re-scaled to reflect the size of the targeted country (World Economic Forum, 1997).

attracting foreign investors is due to an intra-regional trade liberalisation policy<sup>20</sup> as well as establishment of regional blocs such as the Southern Cone Common Market (MERCOSUR)<sup>21</sup> (UNCTAD, 1995; World Bank, 1995b).

### **3.3.2 Business Operating Conditions**

Empirical studies reveal that business operating conditions are among the main decisive factors for investing in a given location or in a certain country, as they reflect the general climate in the host country. These conditions incorporate several elements. First of all, there is the factors of production which include the availability and quality of human resources, capital, raw materials, etc. These components represent a good opportunity for foreign firms to exploit local factors, such as low labour costs and abundant raw material supplies.

The quality and skills of the labour force, rather than the costs, proved to be of great significance in affecting location decisions, particularly when the wage component does not exceed 10-15% of the overall production cost in many manufacturing industries.

Countries offering a well-educated pool of labour have become increasingly attractive to foreign investors.<sup>22</sup> The availability and cost of skilled labour is more appealing to foreign firms than cheap unskilled labour (Meier, 1995). This is quite apparent in the case of South East Asia countries, such as Singapore, Indonesia and Thailand, which witnessed substantial investment from neighbouring countries, mainly Japan, Korea and Taiwan (World Economic Forum, 1997).

In addition to human capital, adequate infrastructure is often cited as a main FDI determinant, as it raises the productivity of private capital. Malaysia's success in attracting foreign investors has partly been due to the government's success in reducing business costs through the provision of adequate infrastructure. Besides

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<sup>20</sup> The degree of the openness of the economy was rated as 15 between 1990-1994.

<sup>21</sup> MERCOSUR includes Argentina, Brazil, Paraguay and Uruguay. This regional bloc offers a vast regional market that triggers FDI. For example, Toyota Motor Company is investing US\$ 100 million in a plant that will produce 20,000 pick-up trucks per year in Argentina, of which approximately half are destined to be exported to Brazil, and for which most of the parts will be imported from Brazil (UNCTAD, 1995; World Bank, 1995b). This implies that such economic blocs do exert an influence on the FDI process. This issue shall be studied in the following chapter.

<sup>22</sup> One of the most striking examples is the software industry in India.

which, the Indonesian government's commitment to reduce infrastructure bottlenecks, particularly in telecommunications and power, has played a positive role in boosting FDI.

One of the top concerns of the foreign investor, related also to the business operating conditions, is the extent of economic openness. This reflects such factors as the ability to repatriate capital and remit profits, the general attitude towards foreign investors, and the deregulation of the financial system with a more flexible exchange rate. In addition, it includes liberalisation trends, anti-trust laws, deregulation and privatisation of state-owned monopolies, all of which are positive ingredients in the general investment climate. The high openness of both Malaysia and Indonesia,<sup>23</sup> has been somewhat responsible for the increase in FDI inflows. In Malaysia in particular, the economic openness has provided favourable conditions for growth, which have attracted, in turn, FDI (UNCTAD, 1995; World Bank, 1996b, 1996c).<sup>24</sup>

Also, privatisation programmes have signalled a government's changing attitude toward foreign firms and the private sector in general. In the case of Argentina, for example, the privatisation process has been quite successful in attracting FDI (UNCTAD, 1995). Another example could be found in Hungary, which has adopted a liberal FDI regime, permitting foreigners to participate fully in a large-scale privatisation programme. In 1995, Hungary privatised electricity production and distribution, and sold one of its largest banks (the Budapest Bank) to the private sector (World Economic Forum, 1997).

In addition, trade and investment liberalisation policies have exerted great influence on FDI locational decisions. Indonesia is a good example to mention. Indonesia has exerted continuing efforts in enhancing competition through trade and investment deregulation. It liberalised its foreign investment regime in June 1994, announced a rule-based, pre-programmed trade liberalisation schedule in June 1995 and has also implemented further financial reforms and regulations. As a result, the country has witnessed an investment boom and significant FDI inflows (World Bank, 1995b and

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<sup>23</sup> The first registering 154 between 1990-93 and 171 in 1994, and the second rising from 43 to 35 in 1985 and 1994, respectively.

<sup>24</sup> Average annual FDI growth registered 8.2% during 1985-95, average annual growth of GDP per capita increased from 4% to 5.8% between 1985-1995 and reached 7% in 1995 (World Bank, 1996c).

1996c). Luca's study (1993) of Southeast Asia countries provided evidence of the relative importance of outward-oriented policies in fostering FDI (Jun & Singh 1995).

Last but not least, the general degree of industrialisation plays a major role in locating FDI, particularly in 'high-technology' industries. Also, existing FDI stock is a factor that generally attracts other investors, as noted by Knickerbocker, since investors usually follow predecessors who have already operated successfully. The more firms invest in a country, the more synergies and linkages are created.

## **Governance**

Most recent studies have confirmed the importance of governance in determining FDI's spatial distribution, as it is viewed by investors as an indicator of long-term stability. Governance is defined as the manner in which power is exercised in the management of a country's economic and social development. It specifies how economic policies are chosen as well as implemented and reflects the general ability of the governing elite to achieve consensus within the rule of law.

The degree of willingness to respect established institutions that implement legislation and resolve disputes is related to the existence of sound political institutions, strong efficient judicial systems, etc., and reflects the extent of economic and socio-political stability. Studies have found the overall perception of political stability plays a significant role in sustaining higher levels of FDI inflows. In addition, governance incorporates the degree of corruption (illegal payments as bribes connected with imports and exports licenses). Studies have shown that corruption acts like taxes in discouraging FDI to a certain extent.

Another factor is the relaxation of bureaucracy. It involves the simplification of rules and bureaucratic procedures, as well as the establishment of investment approval rules, through the existence of one-stop centres within the economy. Furthermore, governance could be also related to the degree and efficiency of foreign investor protections through adequate legal guarantees, whether national legislation, or through investment protection treaties signed with other countries as membership in relevant multilateral agreements. Moreover, reforming the intellectual property rights system is considered a necessity for foreign investors (UNCTAD, 1994).



In general, foreign investors seek governance that guarantees transparent and sustainable rule of law, enforceability of contracts, and competent administration. In addition, investors care about competitive attractiveness, as related to TNCs operations and relationships (ERF, 1996).

To sum up, the empirical studies have highlighted important factors clarifying FDI's geographical pattern and have thereby complemented the theoretical explanation of the FDI phenomenon. They have stressed the importance of the degree of openness of the economy, privatisation programmes, liberalisation policies, stable macroeconomic performance, availability and quality of labour, and infrastructure; all of which are crucial factors for FDI destinations. In other words, foreign investor decisions are influenced by long-term (strategy) considerations rather than short-term and speculative factors, which affect international portfolio movements.

### **3.4 THE EFFECT OF FDI ON DEVELOPMENT**

This research is to tackle the effect of the FDI on both cost reduction and human development.

#### **3.4.1 The Effect of FDI on the Reduction of the Cost of Production**

Through the studies conducted by Romer (1995), Crossman and Meleman (1991), and Bado and Salmartein (1994), it could be said that FDI is the basic and main factor in the production process of technology transfer and spread; it helps to facilitate the adoption of the new modern technologies utilised in the production of new and miscellaneous consumer goods. In addition, there is another effective factor (or a phenomenon) that can be called 'catch and keep up' with new technological developments; on which basis the cost of the process preparation is in reverse proportion to the number of types that are locally produced, and compared to these is produced in more advanced countries.

Since the cost of the imitation of the available goods for a period of time is less than the cost of production of commodities in the phase of creativity, both Crossman and Meleman were able in 1991 to reach a scientific result for the cost of the preparation of production; it states that the increase and variety in production may be interpreted

as a progress and development as concerns the originally available goods and products leading to the same reverse relationship between FDI and the preparation cost. Also, the phenomenon of ‘catch and keep up’ is that, as the cost of the originally available products is reduced, the quality of the product deteriorates, for example, the development of a typewriter is less costly than the development of a computer system.

Through reviewing many of the information sources that relate to FDI, such as the International Financial Statistics issued by the IMF and the availability of information about the total amount of FDI, it is clear that the first Journal contains information about the net flow of foreign capital in the balance of payments, and the second Journal contains information about the flow of foreign capital only.

Also, through reviewing the geographic distribution of capital in the developing countries in the UNCTAD report of 1995, which contains the OECD statistics, the researcher can see the presence of relative agreement that the most important benefits that accrue to the host country of FDI is the transfer of technology and the accompanying increase of the growth of the other accompanying factors, while the economic growth in the country of origin shall not be affected by the transfer or the withdrawal of value of FDI capital from it.

On the other side, the framework through which we work is that the movement of capital from the industrial countries to the developing countries limits or reduces the technological gap. If a movement of investment occurred between countries of similar economic and technological conditions, then the effects and effective factors differ from the previous situation. The nature of this movement may be understood in the light of the international strategy of the institutions and the power to penetrate the markets. For example, the foreign institutions are able to get rid of the trade obstacles and access other advantages enjoyed by the national industries and products. In this situation, it is expected that this type of investment had no noticeable effect on production and technological development.

Hence the study tackled the movement of FDI from industrially advanced countries to developing countries. In addition to this, the movement of investment between the industrially advanced countries may be affected by financial and taxation policies, which cannot be changed so as to bridge the electronic gap. Hence the standards of

the OECD for the study of FDI is the most effective and suitable in spite of the fact that it does not show the general and holistic view of the movement of investment with its different types.

### **3.4.2 The Effect of the FDI on Human Development**

FDI has a clear effect on economic growth, and there are channels through which the benefits of this FDI are transferred to the local economy; through this the researcher tackled the interaction between and the mutual effects of the FDI and the development of human capital, how this interaction affects the rate of the economic growth, and the extent of the efficiency of the investment process in the concerned countries.

Some studies conducted by Kobrin (2001) point to the positive effect of FDI in general, in spite of the fact that the extent and scope of this effect depends on the development of the human capital available to the concerned countries. The studies also included a number of countries and showed that FDI has a positive role to play in the local investment, assuming the presence of the power of integration of these local industries and their support of each other, and also the absence of the removal or the expulsion factor of the local competitor. This is one of the most important indirect effects of FDI on economic growth, as it works to attract other sources that encourage and support investment in general.

The correlation between FDI and the integrated level of human capital show the importance of that relationship, which is evident when the other related variable factors remain the same, especially the variable of FDI. Hence, it is important to add the FDI information and the results of the scientific results of the stage of basic education (it is the standard for measuring the human capital) in a separate way, in addition to the result of the multiplication of one into the other. Hence we can distinguish whether these variables affect the growth individually or in a collective way.

In the same research, the relation between FDI and the agents of change related to the international trade, such as the tariff and the balance of payments were studied and were evaluated taking in consideration the rate of exchange of the foreign currencies

to the local currency in all these situations, but this relationship was statistically of no importance (Kobrin, 2001). Hence these variables seem of no significance regarding the effect on the flow of capital in the sample topic of the research. Also, if we create a distribution frequency table that governs the relationship between human capital and proposed initial income in the model in such a way, the rate of change increases as a result of the increase of the level of the human capital, but this factor was very small and has no effect at all.

The contribution of FDI to economic growth is a result of two main factors; the first is that these investments are in addition to the gathering and accumulation of capital and hence contribute to economic growth. It means that these investments shall not expel or remove the local investment capital or the storage; this expulsion may occur through the competition in the commodities markets or the money markets under circumstances of commercial and financial harassment, for example. The second factor is that FDI contributes to economic growth if the productivity degree and efficiency is higher than the local investments.

### **3.5 CONCLUSION**

The geographical pattern of FDI has revealed several implications: (1) Developing countries tend to receive a reasonable share of FDI inflows if compared with their share in both world trade and GDP, (2) FDI destination shows high concentration among regions and countries, and (3) Most developing countries have a concrete need for FDI to strengthen domestic development efforts.

FDI determinants can be identified by reviewing the economic literature and the empirical studies. The former has presented the necessary conditions for FDI, whereas the latter has complemented the theory by adding the sufficient conditions. The case studies have clarified the factors behind the success/failure of a host to attract FDI and stressed the importance of both economic and institutional determinants. However, governments fulfilling these determinants should still question their validity in the foreseeable future in the light of the recent world developments and challenges.

From the previous remarks it appears that there is some agreement on the understanding that the FDI is more productive and economically useful than the local

investment and, as Graham and Krogerman (1991) tried to prove, the local institutions have both the knowledge and ability to reach the local market. If one of the foreign institutions wishes to enter the local market, it has to consider the advantages enjoyed by the local institutions, hence the operation cost must be lower for the foreign institutions which make the decision to invest and that through the increase of the efficiency of production. Especially in the case of developing countries, it is probable that the efficiency will be related to the high efficiency of the foreign investment for their excellence in the high administrative skills and advanced technology. In addition to the participation of the local labour force, it is possible to consider that the foreign investment is the main channel through which technology is transferred to developing countries. Maybe a number of different disparities and interferences may hamper the foreign investment from playing its role as a means for technology transfer; for example, due to a policy of trade protection, the foreign investment may be the only way to reach the local markets that, ordinarily, the institutions could export products to the concerned countries.

In similar cases, the government may offer some facilities to promote foreign investment to boost the flow of foreign capital, so as to achieve the target of increasing the stock of the foreign currency. Hence for the sake of the development of a certain sector considered to be of a strategic importance from the political industrial point of view, an outcome of these policies may be assisting an FDI that neither affects nor is affected by the increase in efficiency capacity, but interacts only with profitable investment opportunities found through the changing market movements.

It is worth mentioning that this interactive relationship is of almost of no effect in the case of local investment, while FDI affects economic growth in two ways: (1) FDI in general increases the volume and level of investment in most cases, and also attracts local investment in a greater way and this is not affected positively or negatively with the factor of the human capital, and (2) the productivity of the FDI is greater than the productivity of the local investment, and that is a result that is related closely to the qualifications level of the human capital.

This study concentrates on the interactive relationship between the human capital and the efficiency of the quality of the FDI, and it has been proved through practical

scientific observation that foreign investment has a positive effect on economic growth when the educational preparation and attainment were higher than a certain level. As we have previously mentioned, foreign investment is considered a method of transfer for advanced modern technology, also the required training for the preparation of manpower to deal with the advanced technology indicates that FDI may possibly affect the level of the human capital.

The results reached by the researcher indicate that FDI is considered an important tool of technology transfer, and also contributes greatly to economic growth if compared with local investment, hence the high return of FDI must be considered, as it always happens in the countries that have the least limits on human capital. Also, the increase in FDI leads to the increase in the volume of the total investment in the economy, if that indicates anything, it indicates the positive and integrated effect of FDI on the local institutions.

## **Chapter 4**

# **ANALYSIS OF THE ADVANTAGES AND RISKS OF FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES**

### **4.1 INTRODUCTION**

The increasing importance of FDI at the international level appears to every economist when analysing contemporary economic developments; these investments have become one of the most important sources of investment finance in developing countries, especially since the first half of the 1980s (El-Nagar, 1992). As a result, it has become increasingly important to conduct an evaluation of the effects of FDI for concerned parties in general, and on the host countries specifically. There is no doubt that every economic activity has positive and negative outcomes and this requires the host country of the investment to perform their analysis as to the cost and the revenue, in the light of international economic variables, and in the light of the economic and political developments that the country is going through, so as to maximise the gains and to minimise the risks arising from these investments.

The issue of FDI has been the subject of much research and discussion between supporters, who call for its expansion as the first carrier of technology to the recipient state and the best solution for many of the economic problems facing the developing countries, such as the impairment of the investments resulting from the decrease of savings, the increase in the level of unemployment among the citizens of the country, the decrease of GDP, the slowing down of the process of economic development, the decrease in the volume of trade, and the speeding up of the integration into the international economy. The opponents of FDI rely on the probable negative effects on balance of payments, the change in local market structure that might result from these investments, and possible changes in the sovereignty and independence which was enjoyed by the developing countries.

In spite of the arguments about this issue, no one can neglect its importance in propelling economic and social development in developing countries. However, it is

not reasonable that these returns and benefits are acquired by the host country as a gift without any return and without any cost. The argument does not stop; some support the point of view that the foreign investments are one of the best means to promote comprehensive development, while some do not accept that point of view, considering that this type of investment takes more than it gives. Others consider the necessity of setting certain controls to achieve the maximum benefit from these investments. The host country, the mother state and the Multinational Company all have some objectives they seek to achieve. Even within each of the three main parties there are many branch parties that seek to achieve their own private interests, such as importers, the producers of the inputs of the industry originating from the Multinational Company, and the consumers in the mother country. Each party has to seek to achieve its objectives, taking in consideration the objectives of the other party.

Even if accepting some of the sound criticism and arguments, the practical reality and the applied proofs indicate the importance and effectiveness of FDI in its relationship to development in many of the developing countries (Abo Gehaf, 1992). This issue shall be discussed within this research from the point of view of the classical school firstly, then the researcher returns to present the most important advantages that accrue to the developing countries from FDI, and also the most significant losses that they incur.

## **4.2 ADVANTAGES AND DISADVANTAGES OF FDI**

### **4.2.1 Analysis of the Advantages and the Risks from the Point of View of the Classical Theory**

Foreign investments, from the point of view of the classical school, is a game in which a positive result is gained by one player only and that is the Multinational Company; these companies take more than they give. In this context, it is useful to present the points of view of a number of the pioneers of the classical school, so as to understand their views and arguments which are opposed to the point of view of the pioneers of the modern theory.



Baliga (1994) referred to analytical positions of the practices of US Multinational Companies in developed countries.

The colonisation point of view assumes that the host countries are considered a main source for the raw and primary materials and hence the foreign investments there target the extraction of these materials to be used by the mother country or other advanced countries.

The point of view of the foreign investor assumes that the host country, with their many chances of investments, production and marketing of the commodities, represents a profitable market and, to utilise these chances, national investors must participate in the investment projects, on condition that the foreign company retains the right over management and control, and retains the decision on when to execute the investment project. This requires the share of the foreign investor to be more than that of its national counterpart's share in the project. As for the services of the markets outside the host countries, it is preferred by investing companies that they should provide these via the knowledge of the mother company and not through its branch in the host country (Baliga, 1994).

The third point of view is related to the choice of the host country as a site for the investment, and how to operate, manage and organise the investments there. This point of view considers that the Multinational Company has to enjoy a competitive position and hence it is required to choose a host country that is characterised by low cost of labour. It is therefore preferred, whenever possible, to transfer or establish the investment projects that depend on labour element in the first place into these countries and that the routine and mechanical jobs are filled by the national labour force in these countries. At the same time, it is necessary to keep a small size investment in these countries so as to minimise the risks.

Frank (1981) considers that the element of exploitation of the wealth of the host countries by the foreign investors is present with all its facets in the existing relationships between the two parties of the foreign investment, and the fact that foreign investments in developing countries concentrate on the extraction industries is a good example of that. In addition, foreign investments in such industries are not helping to develop strong relationships for front and rear vertical integration with the

other activities in the host country and, at the same time, can lead to certain trends of economic development that can lead to an increasing dependency of the host countries on the advanced countries as the source of the investment. The prices of the primary materials in most cases are very low compared to the prices of the imported commodities and hence the rich countries get the benefit of the rise of the rate of return on their investments and of getting the raw and primary materials required for the industry for the lowest prices (Frank, 1981).

It might be beneficial before presenting the modern points of view, to present the classical point of view, summarised as follows:

1. A great concentration of Multinational Companies in the extraction industries rather than on the transformational or other productive activities might reflect the intent of exploitation on the part of these companies.
2. It might be wrong to assume that Multinational Companies shall be of ideal conduct and practice in their business in developing countries.

The continuous desire of these Multinational Companies to control the organisation and management of their projects in the host countries might make them always prefer that type of direct investment (Hood & Young, 1997). No doubt this might work against realising the developing countries' goal of increasing development and maintaining the ownership of the productive projects as a national property. It might also have a negative effect on their economic independence, if the foreign investors own the investment projects with the probability of interference from the mother countries in the affairs of the host countries.

The fear of confiscation or nationalisation of Multinational Companies by some developing countries may mean that the foreign companies prefer to invest through establishing joint ventures. In spite of its suitability for the company, this will not help to achieve developmental goals for the host country.

Some consider that the intents of Multinational Companies with regard to helping the host country develop may be recognised through the analysis and study of the direction and flow of the foreign investment and its volume among the countries of the world.

Examples of previous incidents and practices of Multinational Companies are few and lack enough evidence as to the causes that led to their occurrence to assure the truth of some of these incidents, but that only helps to spread the feeling of fear in developing countries about opening the door to foreign investments, or perhaps causes them to put many obstacles in the way that affects the extent and volume of FDI flow through Multinational Companies so as to maintain their political and economic independence.

#### **4.2.2 Analysis of the Advantages and the Risks from the Point of View of the Modern Theory**

The points of view of the pioneers of the modern school tend to be those who support the efficiency and contribution of foreign investments to comprehensive development in developing countries and can be summarised as follows.

Carr (1979) considers that when foreign investors carry out direct investments in the host countries and when these investments are accepted, this means the presence of a mutual belief between these two parties that many benefits and returns are achievable through this investment (Carr, 1979).

Mikesell, Vernon and Wells (1994), in their discussions about the special benefits of foreign investments, do not overlook the negative effects of these investments but, at the same time, they claim the extent of the effects of foreign investments on the developing countries depend on a number of factors or variables. For example, we find that the extent of the contribution of the foreign investments to development depends on the nature of the industry or the field allowed for the foreign investment to enter. Also it is important to take in consideration all forms of foreign investment that is beneficial to the host countries in general and, at the same time, it is worth mentioning that foreign investments especially may play an effective role in the efforts of developments in developing countries if these countries were able to direct, organise and plan these investments in a good way. Some examples are mentioned below (Vernon & Wells, 1994).

FDI was considered a good source for obtaining foreign currencies or capital which forms a major support for any developmental programme in developing countries.

FDI may play a role in the development of national ownership and the creation of a class of future businessmen and women through the contribution of the individuals of the community to the investment projects by the procurement or import of the raw materials or the distribution the products of the foreign investment projects.

FDI was considered a good and effective source for the transfer of modern technology to the host countries, despite the fact that there are other ways or channels for the transfer of technology other than the direct investments; the host countries can procure the technologies through electronic contracts and licenses and also published research and direct purchase. Yet direct investments represent the most feasible way to get the technology especially for some types of extraction industries. Also at a certain level of economic development, industrial development in a certain country requires the availability of trained manpower, specialists, technicians, and engineers in different fields to enable these countries to utilise the technology that was procured. In addition, the country cannot maintain its competitive position in the foreign markets (the exports) unless it produces and markets new products of a proportionately high level of technical development which is not less than its competitors in the foreign markets. As for the frustration resulting from the issue of exploitation and the costs of transporting or getting the technology through direct investment, there are many controls and procedures that the host country can apply to avoid such issues.

FDI can help in a good way, not only in creating new job opportunities, but also in development, training and the utilisation of human resources in the developing countries, taking into consideration that the extent of contribution depends on the controls and procedures that help to achieve these benefits.

Foreign investments help in opening new markets for exports, especially when the Multinational Companies that are investing in productive activities in a certain country has control of some commodities' markets at the international level, or in the mother country.

Stoever's (1988) point of view sums up that FDI contributes to raising the rate of capital formation in the host country through increasing the number and value of the production projects and the capital equipment there. In addition, the foreign

investments help in the development and renewal of infrastructure projects such as roads and wired and wireless means of communications; this might raise the level of the national product, the creation of job opportunities, and the development of the human resource and its effective utilisation. Also, foreign investments tend, in general, to improve the balance of payments through increasing the possibilities of exports, the reduction of imports, the inflow of foreign capital, and the economic, social and educational development of under-developed areas, in addition to the creation of new job opportunities. The presence of Multinational Companies helps to establish the economic, social and political relationships between the mother country and host country (Stoever, 1988).

Hood Wing (1979) recognised the importance of foreign investment in encouraging development in the host country and he summarised this in the following points (Hood Wing, 1979).

- The effects of Multinational Companies on the host developing country must be codified not only from the theoretical side but also the practical side, in the political or the economic or the social fields.
- Multinational Companies should be considered from comprehensive modern point of view as the most integrated method or tool for utilisation of natural and human resources on a large scale, due to their technical and administrative capabilities that were not available to their counterparts of the national companies in the developing countries.
- There is no 'one party game' between the Multinational Companies and the host countries, as there are mutual interests that serve both parties.

The researcher's point of view is that this issue needs objective and accurate calculations to illustrate the advantages and disadvantages of FDI and, as long as these investments lead to the increase in the size of the national income of the host country and the increment goes as a whole to the foreign investor alone, the net effect should be calculated (advantages and burdens) of FDI from the point of view of the host country.

In spite of the advantages, still the opponents of these investments continue to express their worries about the negative results of these investments, considering the different burdens that accompany the flow of these investments. Before considering the advantages and burdens related to FDI, it should be pointed out that, for developing countries, there are some difficulties in making precise calculations about profits and losses resulting from these investments and it is also more difficult to generalise if the net effect of these investments shall be negative or positive due to the following considerations:

1. That profit and loss may differ from one project to another and from one country to another.
2. Profit and loss calculations related to FDI contain elements that are not all homogeneous, and not always tangible or easy to measure, and hence it is difficult to compare or make a balance between the various elements.
3. It is not easy to create accounts of the net profit or the net loss due to the absence of the 'specific target function' for developing countries, since this is an important and necessary function to show the national objectives of the economic and social developments and also the relative importance for each of them (Ebrahim Hassan El-Eswai, 1976).

#### **4.2.3 Advantages Related to FDI**

Those in favour of FDI mention that it achieves many advantages for the host countries; this part shall concentrate on the advantages connected to the process of technology transfer to the host country, and also to probable effects on the currency there (Cantwell, 1989).

#### **Foreign Direct Investment and the Transfer of Technology**

It may be the most important reason that explains the change in views in many of the developing countries and also the countries in the early stages of moving towards FDI; the belief of countries that this type of investment may be an important means for technology transfer to these countries, technology in its broader sense including the skills and organisational, administrative, and marketing capabilities. The process of technology transfer may be through different means such as selling technology, the agreement of licenses and technical assistance contracts, and there are some studies

that were referred to by Kumara (1993) that pointed to Multinational Companies being considered one of the most important means for technology transfer between the countries directly or indirectly. High levels of technology and innovation capacity may be a characteristic that distinguishes companies that practice FDI, and maybe this characteristic is the one to depend upon to compensate for the costs suffered by the local companies due to their connections to the foreign investments.

The rapid spread of technology transferred to the host countries may depend upon a number of factors: type of investment (completely foreign-owned or joint venture); type of technology; cost of the technology; the degree of complexity of the technology; the absorption ability of the labour, and the relationship between the imported profitable technology and the extent of the suitability of the products in its final shape to the market (Kumara, 1993).

### **Foreign Direct Investments and the Improvement of the Efficiency of Utilisation of the Host Country Resources**

The technological excellence of the Multinational Companies led many researchers to stress the characteristics of the foreign direct investments which lead to maximising efficiency, as these investments were mostly connected with achieving secondary advantages through the spread of technology within the companies in the host countries. This spread might be intentional, such as a Multinational Company giving a license permit to a local company, or it might have the effect of a 'technological spill-over' that, in the case of the Multinational Companies, achieves advantages and returns for the local economic entities that exceed that which was targeted by these companies. An example might be the Multinational Company which carries out some operations of arranging and classification of the local companies that deal with them in accordance with their technological capacity; this arranging and classification meets certain requirements imposed by the Multinational Companies (Cantwell, 1991). The assurance of the difference of the effect of these investments on the efficiency of resources utilisation is in accordance with the variety and flexibility of the production facility of the host country.

The technological flow might be horizontal or vertical; the horizontal flow occurs, for example, in the case where the branch of the Multinational Company acquires a new

technology and hence the competitor companies transfer that technology or study it. The vertical flow of technology is achieved when the branch transfers the technology without any payments against it to the companies which provide it with the inputs, services and processes in the same direction such as the distribution and retail business. Maybe the distinctive characteristics of the transfer of technology is what is called by the economists 'positive externalities', which are the advantages achieved by the host country and were not considered by the Multinational Companies when making the decision to invest in a certain country. These advantages were gained by the host country in full except in the case of severe competition to attract the foreign investment where it resulted in the excessive payments of incentives and guarantees. In the case of the last example a part or maybe all these indirect advantages were gained by the Multinational Company.

In addition to the spread of technology, FDI produces indirect effects to maximise efficiency as local companies will be compelled to compete and to make arrangements and classifications for its technological capabilities; this is due to the pressure of competition from the branches that belong to the Multinational Companies in the host countries. On the other hand, these branches produce high quality goods at the local market level of the host country; this compels the local companies to produce competitive products and this entails that the local companies adopt different procedures so to be able to complete the process of arrangements and classification of its products. This can be achieved either through the development of the technology used in the manufacturing process, in the provision of services, or the development that occurs in the intangible fields due to the spread of the technology in the developing countries. This affects the level of quality, the efficiency of the administration, the reduction of the cost of production to the level of the international competition, and the intensive use of R&D to introduce new products. In the US, for example, the entrance of the Japanese automotive companies into the local market through FDI compelled the local automotive makers (who were also Multinational Companies) to conduct an operation of arrangement and classification of its products and also assess the efficiency of the facilities of the local production. This situation can offer different advantages to the consumers in the US when they purchase either Japanese or US types of cars. This might prove that it is possible to achieve some



similar advantages in developing countries. For example, Korean FDI in Bangladesh contributed to the development of the ready-made clothes industries for exports, locally owned in Bangladesh.

The local branches of foreign companies might conduct activities in R&D targeted at adapting the innovations of the mother company to fit the local conditions. However, there was a study conducted on a number of South Asian countries that indicated that the activities of R&D carried out by the Multinational Companies in these countries is considered relatively very meagre, and also the training that is received by the local workers in this field is at the lowest level (Kumara, 1993). There are a number of important reasons which could explain the meagre R&D activities conducted by these companies in the host countries:

- The management of R&D in a widespread manner through the employment of local labour will weaken the excellence of the Multinational Companies if these companies did not deal with that issue in a very rigorous manner and as planned.
- The Multinational Companies were not receiving any incentive that led them to conduct R&D in the host country to offset the risks they faced.
- That both the governmental support and cooperation in the field of R&D and also the presence of the other research institutes were available in the mother country.
- The lack of skilled labour capable of performing the work results in a high level of risk for the Multinational Companies as this lack does not support R&D activities.

In spite of the difficulties of measuring the effects of FDI on the maximisation of efficiency, the writings concerning the practical studies indicate some important results as follows:

- There is some agreement on the importance of FDI; it is the first main channel for advanced technology transfer to developing countries.
- Also there is some agreement that FDI leads to a rise in productivity of local companies, especially in the manufacturing sector.

- The volume and type of the transferred technology through FDI is affected by the different characteristics of the industry and of the recipient countries, since the atmosphere of competition leads to a higher level of local investment in fixed capital and education. An environment that imposes fewer restrictions on the branches that belong to the Multinational Companies appears to lead to an increase in the expansion of the technology transfer operations.

### **Improving the Efficiency of the Human Resources in the Host Countries**

When searching for the probable effects of FDI on recruitment and labour, either direct or indirect, it is a must to refer to the applied studies that handle the effects of FDI on labour but these are still limited and of varying results. Some studies point to the effects of these investments on labour and conclude that there is an important role in raising the levels of employment through the direct work opportunities availed by the flow of foreign capital inside the host countries, and also the volume of the surplus and profits reinvested locally. But the most important thing is the indirect job opportunities that were achieved through the links with the local industries, the rise in the level of production in the community, and the change in the pattern of income distribution to the benefit of those with a high inclination towards savings and investment. Some other studies indicated the opposite.

### **The Burdens Associated with FDI**

The target of this research here is to evaluate the burdens without exaggeration or underestimation of the effects on the host country and to present the points of view concerning these burdens. Here, three of these negative effects of FDI shall be dealt with: possible negative effects on the balance of payments; possible effects on the local market structure, and the possible effects on local economic policy and the understanding of sovereignty and independence.

There are others who have doubts about the employment capacity of the Multinational Companies; this is due to the bias of these companies in favour of capital intensive industries, their attraction of skilled technical labour from other sectors, the weak front and rear links with national companies, and their inclination to raise the level of wages which encourages the substitution of machines for labour (Sagar, 1992).

## **The Probable Negative Effects on the Balance of Payments**

The first effect of FDI is reflected in the flow of foreign capital and the material increase of capital in the host country; it is positively reflected on the capital accounts balance in the case of the foreign companies resorting to selling their foreign currencies to obtain the national currency they need to fund their local payments. In the following stage, it contributes to the reduction in the scarcity of foreign currencies if the foreign investments were directed to the sectors of imports substitute, as these contribute to meeting a part of national market needs (El-Faiyomi, 1982). This effect might be of greater importance than the negative effect of capital and the interest transfer on the balance of payments, also the balance of payments is improved if the direct investment contributed to expanding the volume of the export to other countries of the world, or to re-exporting to the mother country. It is likely that foreign companies enter the successful exports markets because they have a well established reputation for quality and import credibility, along with knowledge of the foreign markets. In general, at the beginning the imports of the capital goods needed by the foreign companies will increase.

When these companies commence production, the final products and other commodities previously imported by the host country will incline to decrease gradually, as the above-mentioned companies will now produce commodities to meet part of the of the national market needs.

Critics and opponents of FDI mention that the initial or direct effects of these investments on the balance of payments of the host country might be positive due to the increase in the proceeds of that country of foreign currency of the capital transactions account. In addition, Multinational Companies allow the host country more capabilities to enter the export markets and increase their exports in the light of the companies' international communications, experience in the international markets network, and the reputation of these companies in the international markets associated with their name and trademark. Yet these effects on the balance of payments in the medium term are mostly negative due to the following reasons.

The positive effects on the balance of payments associated with the flow of the FDI shall change to negative effects, since the activity of the Multinational Companies will

lead to an increase in the imports of the host country of goods and services. Also these companies will start to transfer their profits abroad, in addition to the payments of the interest on the imported funds for these companies from the banks abroad and also the payments of patent's rights and technical assistance. There is also the transfer of the salaries of the foreign employees in these projects abroad, and there are indirect costs that must be taken in consideration in the case that the current revenues of the foreign currency to the host country were not enough for the service of the FDI.

In spite of the agreement regarding FDI's ability to increase the exports of the host country through the activity of the Multinational Companies and their wide communications network throughout the world in many international markets, there are some practices by these companies that limit the importance of this capability. One of these practices is the reduction of the exports of the branches of the company in the host country since, in many cases, the branch is prohibited to export that which the mother company is exporting to the international markets. Alternatively, it may be that these branches are allowed to export to certain markets or according to restrictive clauses, as some of these companies might need to protect their markets or the markets of some of the other branches that belong to them. Also some of these companies might seek to organise the return of technology and the technical assistance it owned, since the limiting of ability of some of the branches to reach certain markets offers a suitable chance for establishing other branches that purchase the technical know-how and their production which covers these markets.

As a result of a pricing policy, the exports and imports followed by the Multinational Companies, especially in the case of vertical integration with a number of their branches, may exert more pressure on the balance of payments of the host country, since the mother company may raise the price of the goods and services it provides to some of its branches (over-invoicing). Also the mother company may resort to the pricing of the exports of goods and services from some of its branches at less than their actual value; the reason behind adopting such policies of pricing of imports and exports is that the Multinational Company tries to transfer the tax burden from a country with a high rate of taxation to a country with a lower rate of taxation. Also some companies might use that means as it is considered the most suitable way for

transferring the profits from a country that imposes strict restrictions on their transfers to a country of fewer restrictions in the same field.

Some of the studies indicate (El-Sayd Fawzi, 1992) that Multinational Companies have played an important role in developing industrial exports, as has happened in the countries of South East Asia; these companies played that role either directly through exporting the products of their branches in developing countries abroad, indirectly through the spread of their techniques in the national local companies in developing countries, or through their contribution to joint ventures leading to a rise in the efficiency of the national companies, hence the products of these companies become more competitive in the international markets. Also, the international companies may contribute to the increase of exports through agreements they make with companies or the local governments that concern the marketing and distribution. There are some positive notes and remarks referred to as follows; some FDI found in some countries had a high degree of protection on the imports, and they become less directed to export from these investments in these countries with lesser level of protection.

The effect of FDI on the balance of payments depends on the system of the exchange rates used in the host country. In the light of flexible exchange rates, any disparity between supply and demand on the foreign currencies is corrected through modifying the exchange rate. In the case of the increase of demand over supply, the exchange rate is decreased. If the country was applying fixed exchange rates, then the net increase in demand for the foreign currencies resulting from FDI shall lead to a decrease in the surplus or an increase in the deficit of the balance of payments.

### **The Possible Effects on the Local Markets Structure**

If we considered the position of Multinational Companies in the markets of the host countries we shall find that they enjoy a monopolistic or a semi-monopolistic position, and that is either as a result of being the sole producers of certain distinctive items or goods for which there is no available alternatives in these markets, or that the companies control a large segment of the market demand for that commodity in the host country, and this enables that company to maintain price leadership because of choosing production fields that were subject to the monopoly of the minority, and characterised by a high degree of market concentration (WTO Annual Report, 1996).

In general, Multinational Companies were considered more powerful economically than their local competitors and hence these companies have the power to deal with the different restrictive practices in the host countries, and also with the obstacles that limit the market entry. In the case of the ability to attract FDI through the reduction of the tariffs of the host country, this might lead to the possibility of foreign countries entering in accordance with a certain style of 'follow the leader', i.e., to follow the flow of investment.

### **The Possible Effects on Local Economic Policy and the Concept of Sovereignty and Independence**

The opponents of FDI raise some issues related to the effects of these investments on the general policies of the host country and also its eligibility to be subject to foreign governmental pressure in an indirect form through FDI.

Multinational Companies may subject the national interests of the host country to these pressures also and hence the activity of these companies may lead to jeopardising the economic and political independence of the host country, but perhaps to a varying degree. This may be due to the branch of the Multinational Company controlling its international trade relationship as it enjoys many of the alternatives not available to the national companies; the Multinational Companies therefore conduct some practices the national companies cannot afford, such as avoiding compliance with general policies of the host country relating to the social and environmental aspects. These aspects might raise the cost of production and so the Multinational Company can easily transfer its activity to another country that does not have this legislation. Also, the ease with which these countries can obtain the necessary finance in the form of loans from a number of international sources may nullify the total economic policies of the host country as related to internal and external balancing.

As for yielding to the pressures of governments of foreign countries and the effect of that on the host country, that is minimised by the fact that the branch of the Multinational Company is responsible to two political authorities; these are the government of the host country and the government of the mother country (in which the parent company was established). No doubt Multinational Companies seek to maximise their profits at the international level and this leads these companies to tend

to concentrate the authority to make the important decisions in the hand of the mother company instead of allowing the decentralisation and delegation of authority in decision-making to their branches in the host country and especially the under-developed countries.

There is also an important issue that should be referred to, which is the activity of those Multinational Companies in the host country that leads to the creation of a class of beneficiaries whose interests are linked to the interests of those companies. The satisfaction of that class and achieving significant gains depends on the continuity of their connection to those companies inside their countries. This class of beneficiaries includes a group of traders, importers, agents, brokers and others who work with these companies or for their benefit; these constitute a pressure group for the defence and continuity of those companies (El-Eswai, 1976).

Actually, the possible effect of FDI on the labour force varies from extremely positive to extremely negative. On the positive side, it can be seen that Multinational Companies can bridge the gap found in the developing countries in the higher administrative levels, facilitate the employment of local labour, and also act to transfer skills to directors and local organisers. On the negative side, the opponents' point of view is seen, that Multinational Companies control what they possess of skills, especially the ability of project organisation and also what they own and transfer of the technology. In addition, the foreign contracts provided by these companies may have little effect on the development of the local resources and human skills, but may impair development and growth due to the control by these companies on the local markets. However, the studies show the effect on labour and employment can only be determined by each case alone. The effects depend upon the practices of the Multinational Companies, the regulatory environment through which they work, and also on the skills of the labour force in the country receiving the FDI.

### **The Effect on Production and Employment**

FDI may have positive effects on production and employment; national companies may not recognise the available national investments, or they recognise them but were not able to implement these investments for reasons that were related to weaknesses in financial and technical capabilities. The foreign investor has previous experience in

this economic activity and more knowledge about the production and marketing skills. Hence the investor will have more capabilities and be more efficient in the implementation of the projects in the host countries which lead to new opportunities and incomes, and employment will increase relative to the export of labour-intensive goods.

However, there is a difference in the volume of the FDI contribution to the national production and employment in the host country. The actual indicator of this contribution is in the income generated by the elements of the national production, i.e., the added value generated through national production elements and not foreign ones. Hence the paid income of the foreign companies to non-national elements of production does not represent a real direct value to the host country except in the locally spent part of it. Also the source of the inputs used in the foreign companies implementing foreign investment must be taken in consideration when estimating the contribution of the mentioned production in production and employment. The branches of the foreign companies may purchase the raw materials and the other production requirements from the host country and this is likely to create locally appropriate circumstances for the birth of the manufacturing industry or the complementary industries that might be encouraging to national production and the creation of new job opportunities. On the other hand, if the foreign companies resorted to importing the greater part of the factors of production from the parent company or from abroad, then its contribution to the national economy decreases and the figures of the sales of the foreign company shall not be of a significant indicator for the estimation of the mentioned contribution.

### **4.3 CONCLUSION**

This section provides a conclusion for of this chapter and a conclusion for the previous discussion on the theoretical foundation of the FDI phenomenon and its relevance in explaining FDI determinants. In a nutshell, FDI is a major phenomenon that is shaping the new world order. It has been a driving force in world trade that controls cross-border transactions, thereby changing the global map of production and trade. It has strengthened international integration of domestic markets. FDI has been partly responsible for the increasing geographical extent and complexities of TNC



activities, as well as the intensified competition throughout the world economy. Over the past few decades, FDI has recorded high growth rates, exceeding that of both world trade and GDP, and is anticipated to continue this rapid growth in the foreseeable future, as more and more countries are opening up their economies and liberalising their trade as well as investment regimes.

Moreover, competition for FDI attraction is expected to become fiercer. FDI is considered an important means for firms to attain optimal global resource allocation, thus acquiring competitive advantages; while host economies perceive FDI as a means of achieving development goals.

This study has focused on exploring several aspects related to the FDI phenomenon. In this context, four broad conclusions could be drawn from the analysis. The first conclusion is concerned with the main features of FDI that differentiate the phenomenon, namely, capital flows, portfolio investment and TNCs.

The study shows that, although FDI is a long-term financial flow from a parent company to an overseas firm accompanied with some degree of control, it is not limited to capital movements, as it involves a transfer of resources package, motivated by a set of interrelated factors. In addition, capital flow related to FDI activity is not necessarily confined to equity participation; it would take other forms, such as supply of machinery, technology, knowledge and skills. More importantly, in some instances, FDI might not incorporate any capital movement, but rather raise local funds for financing investment.

Regarding FDI and portfolio investment, they are both classified as long-term capital movements that share the stimulus of operating in more than one country and acquire claims on transferred resources. However, FDI does differ from portfolio investment in terms of nature, underlying factors, direction and impact. Portfolio investment is a capital movement of speculative and unstable nature that takes place from one country to another, motivated by interest rate differentials; whereas FDI does represent a firm's activity extension across countries in the form of capital and other resources in response to long-term profitability prospects. FDI incorporates a fully-fledged package of resources accompanied by a degree of control. It is driven by several factors, such as competition, circumventing uncertainty, gaining access to market

shares and raw materials, exploiting certain advantages; and is, accordingly, of a more stable nature. Furthermore, unlike portfolio investment, which moves in one direction (from low to high interest rates countries), FDI is a two-way phenomenon; as an economy could be a host and a home country at the same time. Compared with portfolio investment, FDI is likely to promote economic growth, as it focuses on technologically advanced sectors and increases the stock of production factors. In addition, concerning their claims on resources, FDI has a claim to a share of net output while portfolio investment usually requires a debt-service payment.

As for FDI and TNCs, FDI could be regarded as a movement of capital, tangible and intangible resources that embrace, in addition to TNCs, other forms of activities, such as joint ventures and non-equity arrangements (e.g., licensing, management contracts). However, the terms FDI and TNCs are used interchangeably, since TNCs are the main vehicle by which FDI is transferred all over the world.

The second conclusion is related to the factors driving firms to engage in FDI from the home countries' perspective. Throughout the economic literature, the FDI phenomenon has been studied, either as a part of international trade theory, or in the context of firm theory. Although FDI is a proliferating phenomenon of paramount importance, so far no theory has dealt with the issue. The traditional trade theory is based on the assumptions of perfect competition, complete international factor immobility and negligence of technology's role in both trade and international production. With these underlying assumptions, the traditional trade theory has failed to provide a theoretical foundation for FDI movements. Yet one cannot ignore the importance of traditional trade theories which introduced the concept of comparative advantage. Later on, this concept has contributed to explaining FDI, though in a wider context than Ricardo's analysis, based on international differences of labour productivity. Comparative advantage could be a result of technological progress and economies of scale which could induce, in turn, FDI flows.

The basic assumptions underlying FDI behaviour are market imperfection, product differentiation, economies of scale and are found in the modern trade theories. Although the phenomenon of FDI was not explicitly spelled out, the analysis of most of these theories did outline the analytical framework of FDI. For instance, the

imitation-gap theories stressed the role of technology, which has been considered later as one of the major forces underlying FDI. Also, the similarity of preferences theory has shed light on the importance of demand reflected in market size, both in trade and FDI. In addition, the monopolistic competition theory has emphasised economies of scale and product differentiation as the main features of the world economy, which are also the main features of FDI activities.

On the other hand, the firm theory has provided, to some extent, a satisfactory explanation of FDI. Hymer (1976) was the first to focus on control as the main FDI feature. Based on market imperfections, foreign investors undergo FDI activity in order to exploit unmarketable advantages. Moreover, other theories focused on motives driving FDI. Vernon's product life cycle theory considers FDI flows among developed economies as a result of technological differentials while, in case of developing countries, a result of cost differentials. Besides, the internalisation approach developed by Coase, Buckley and Casson (1985) regards FDI as a means of exploiting an advantage, circumventing uncertainty and as a mode of profit maximisation. Lastly, and most importantly, is Dunning's theory in which he introduced three advantages (ownership/locational/internalisation) to be necessary conditions for FDI. Dunning's OLI paradigm is considered at present the most comprehensive theory.

Furthermore, the review of the economic literature has been beneficial in clarifying whether FDI is an industrial or a trade phenomenon, the extent of complementarity between trade and FDI and if the two can be interchangeable. In effect, FDI is mostly interpreted as an industrial phenomenon taking place across national boundaries. It represents one of a firm's means of expanding abroad and one of the competitive strategies for exploiting their own advantages, as well as gaining market shares. Concerning the relationship between FDI and trade, several implications could be derived from the literature. For instance, Hymer implicitly argues that a firm does not undertake FDI unless the cost of investing and operating abroad (FDI) is less than the corresponding costs at home (trade). This means that he viewed FDI and trade as alternative ways to serve a foreign market. Another example has been presented by Vernon, who considers trade and FDI to be successive production stages for a foreign

market, where trade takes place at the earlier stages of the product life cycle, and then is followed by FDI. In this case, they are complements rather than substitutes.

However, one should stress the fact that the relationship between trade and FDI cannot be easily and accurately determined. In case of tariff and non-tariff barriers, FDI could substitute for trade. On the other hand, trade itself could be constrained by rising costs and currency appreciation. In this latter case, the choice is not between trade and FDI, but rather between FDI and losing a part of the market. Therefore, FDI and trade should be both regarded as different ways of servicing foreign demand, rather than just complements or substitutes.

In the above-cited theories, the focus has been on home country motives for FDI with little attention to host economies' factors of attraction. The previous explanations have stressed, in effect the 'necessary' conditions for FDI outflows without reference to the 'sufficient' conditions for the selection of specific destinations.

The third is concerned with these sufficient conditions which explain the spatial distribution of FDI. In other words, why do foreign investors choose particular countries in which to locate? In this regard, different empirical studies have revealed that investment factors such as tax holidays, corporate tax rates and structure, cheap credit and investment incentives do play a minor role in inter-country investment decisions. On the other hand, studies have indicated that the main factors responsible for FDI geographical configuration could be grouped as follows.

### **Market Size**

Both national market size (measured by its GDP as a proxy for its size) and expected market growth do play a crucial role in attracting FDI. Foreign investors are usually attracted by vast growing markets, as they enable them to exploit efficiently diversified resources, as well as their advantages, and to benefit from economies of scale (China and Malaysia are good examples to cite).

### **Business Operating Conditions**

These conditions reflect the general business climate, which includes the provision of adequate infrastructure and a pool of skilled labour through human resource

development. It also includes the reform of the financial system, the provision of an efficient stock market, a favourable legislative framework with no discrimination between local investors and foreigners, allowing for free capital and profit repatriation, the simplification of administrative and regulatory procedures, and dismantling of bureaucratic intervention. These factors are likely to attract investors. Moreover, domestic rivalry that ensures efficiency, through decreasing the government role, adopting liberalisation trends, anti-trust law and privatisation programmes of state-owned enterprises also enhance FDI flows.

Therefore, efforts towards privatisation and liberalisation of trade and investment need to be sustained in the future, particularly those that most host developing countries that have succeeded in attracting large FDI flows, have taken. Last, but not least, the degree of openness of the economy implies an export-oriented market that is appealing to foreign investors.

### **Governance**

Empirical evidence has illuminated the significant role and governance and institutional factors (e.g., macroeconomic and political stability, credibility, transparency, accountability, etc.), in addition to economic determinants in fostering FDI movements.

Foreign investors are seeking stable, sound and transparent macroeconomic policies that could, to a certain extent, guarantee a hospitable investment climate and socio-political stability to overcome uncertainty which is the main impediment to FDI. Countries have attempted to tackle the issue by offering guarantees against expropriation, as well as providing safeguards for property. Also, the Multilateral Investment Guarantee Agency (MIGA), constituted in 1988, has been offering insurance covering currency transfer restrictions and expropriation.

The fourth conclusion is related to the extent to which multilateralism and regionalism are expected to affect FDI magnitude, prevalent motives and factors shaping its geographical distribution.

Concerning multilateralism, it has manifested itself in GATT's interference in regulating international investment resulting, in both TRIPS and TRIMs agreements. It is expected that the TRIMs impact would either be positive or negligible. On the one hand, it could increase credibility, transparency, liberalisation and openness. On the other hand, it could be negligible, especially since most economies have already eliminated restrictive investment practices on their way to economic liberalisation. Regarding the TRIPs agreement, it implies a degree of protection and guarantees the rights of foreign investors thereby creating a conducive investment environment. The agreement is anticipated, not only to boost FDI in developing countries, but also to enhance technology diffusion, thereby raising their efficiency.

Regionalism, on the other hand, is anticipated to stimulate FDI due to several factors. Regionalism provides access to vast markets, secures supply of diversified raw materials, stimulates economic reforms in member countries, furnishes effective dispute resolution mechanisms, and implies a more predictable policy environment with a high degree of harmonising of rules and credibility. Moreover, regionalism liberalises capital movements, contributes to increasing competitiveness and raises overall efficiency, all of which exert a great influence on triggering foreign investors (the EU, NAFTA, and MERCOSUR are illustrative examples). Accordingly, one could argue that developing economies ought to engage in economic blocs to increase their FDI share.

Although both multilateralism and regionalism do help in boosting FDI, the latter is likely to be more influential, as it embraces a wider scope of factors relating to macroeconomic policies, trade liberalisation, and reform of investment regimes; whereas the multilateralism impact is limited to some aspects covering investment incentives and property rights. Moreover, regional agreements tend to be more binding and credible, implying a more stable investment climate.

Nevertheless, both do not guarantee FDI inflows to specific countries unless host governments continue working on economic and institutional reform programmes. Establishing a sound, convenient, transparent open economic system; a conducive business environment; and a high rate of growth are the main determinants enhancing

FDI. Therefore, developing economies, which are in great need of FDI, have to fulfil these conditions. This need could be attributed to two main reasons.

Firstly, developing countries perceive FDI as a main source that could contribute to their growth, whether directly or indirectly. It could enable them to converge with richer countries in per capita income levels, by providing them with sources of growth (accumulation of both physical and human capital, efficient resource allocation and technology advancement). Most economies seek FDI to play a major role in filling in the resource gap between targeted investment and locally mobilised savings, thereby acting as a supplement to domestic investment. FDI could also increase competition with local firms; hence, improve resource allocation and upgrade efficiency. In addition, FDI might rectify factor endowments, especially in labour-surplus economies by easing capital and technology flows. Moreover, FDI could indirectly contribute greatly to the economic performance of the host country, increase its productivity, diversify its industrial base and raise its efficiency, all of which would improve its competitiveness position.

Finally, FDI might be beneficial in strengthening their market capabilities through access to vast markets. This could be of paramount importance, especially for developing countries suffering from narrow markets, or lacking information on foreign markets and trading networks.

Secondly, most developing countries are currently witnessing a transitional period. Foreign investment might complement their liberalisation policies and policy reform programmes.

Consequently, host governments should consider putting fulfilling FDI determinants at the top of their priorities. At the same time, they ought to screen FDI and assure consistency with development goals to reap potential FDI benefits. In addition, they should adopt several means for promoting foreign investors:

- Promotion programmes; such as information campaigns and other activities that aim at improving their country's image.
- Providing general information, especially on investment approval, concerning the country's investment regime, etc.

- Matchmaking, which involves identifying the investment opportunities in the country on one hand, and seeking the interested foreign investor on the other hand.
- Investment missions, including investment programmes designed and implemented so as to respond to investor enquiries (UNCTAD, 1994).

Moreover, host governments ought to guarantee acquiring potential FDI benefits. This could be achieved through appraising investment proposals, ruling out inefficient ones and comparing proposals with feasible alternatives. Host countries should strengthen their bargaining power and improve their position towards foreign investors, which requires devoting the bargaining task to an equally well-trained and well-informed body of nationals, drawn from several sectors. Besides this, it requires building up their own stock of knowledge, drawing on each other's experience, seeking help from consultants in other countries, as well as securing assistance for different international organisations, as UNCTAD and United Nations Industrial Development Organization.

In addition, host governments could play a major role in controlling wage policies, employment conditions, trade union activity, social security requirements, training and so on. Governments could promote supplier capabilities and provide profit incentives for foreign investors, encouraging domestic resources usage. Moreover, it could undertake to limit an FDI's local borrowing and induce them to accept local capital in the form of equity rather than loans, and also could encourage domestic research, through undertaking cooperative ventures with other developing countries, or induce foreign companies to achieve this task.



## **Chapter 5**

### **METHODOLOGY**

#### **5.1 INTRODUCTION**

This chapter describes the method applied in researching this thesis. In conducting this research, a combination of qualitative and quantitative methods have been employed. The case study approach has been chosen to investigate the measures taken by the government of Sudan to encourage FDI and whether there has been any significant growth in the amount of FDI according to the influence of public policies on inward FDI flows. The sampling procedure is described, followed by the means of data collection. Methods of data analysis and limitations of the research are discussed. Finally, the framework for this research is introduced.

Every research project should include secondary research because secondary data gives an overview of what has been researched before in the same subject areas, which will not only help to choose a research topic and place the research in context, but is also crucial for the decision on research design (Greenfield, 1996; Bell, 2001). The researcher utilised secondary information from companies, websites and from the centres of information of the related companies, to identify companies that conduct business in Sudan. The researcher used the case study approach to investigate issues relevant to FDI and TNCs doing business in developing countries.

The present study could be described as being historical, descriptive and analytical. It is limited to period of 20 years, 1990 to 2010, therefore all data, information and documents relate to the above period. In conducting this research, combinations of qualitative and quantitative methods have been employed. Therefore, in order to examine perceptions, questionnaire and interview survey approaches were used. These surveys are conducted with the objective of collecting primary data to be analysed for inferences. These approaches are vital for this research to support, substantiate and hence validate the findings from the revealed comparative analysis.

The bulk of the information and data dealing with the topic of this study was obtained through direct meetings and personal interviews with the officials of the Ministry of

Foreign Trade, the Ministry of Foreign Affairs and the Ministry of Investment. In addition to this, the researcher has in his possession a wide range of specific information and data related to this topic of study, which has been collected by him through his working for the Ministry of Foreign Trade and his participation in a number of conferences and events of the WTO held in Seattle, Brussels, Doha, Geneva and Cairo. Finally, secondary information and data related to the topic of the study has been derived from reference books, workshop papers, documents, periodicals and reports.

In accordance with the aim of the research study and the critical issues raised above, the study adopts a mixed deductive and inductive approach in analysing the phenomenon under investigation by critically reviewing both economic literature and empirical evidence. At the outset, the study reviews different economic theories relating to international trade and firm behaviour with the purpose of investigating their relevance and significance in explaining the FDI phenomenon. Factors influencing the motives and behavioural patterns of TNCs are highlighted, being the most important vehicle of FDI.

An assessment of the relevance of economic theories supporting the vehicle of FDI is provided through the examination of illustrative examples of developing countries that have been successful in attracting FDI.

In order to examine the reliability of the study conclusions, recent international developments are investigated with a special focus on their potential implications on FDI for both home and host countries. The field method was used to obtain the data, the information collected was principally of a qualitative nature. This fact influenced the researcher's choice of the method of data analysis.

The interview questions were based on a theoretical discourse on the subject of the formation and management of alliances by Doz and Hamel (1998). The researcher arranged initial contacts, sent out questionnaires to key personnel and officials, and also interviews were scheduled. Prior to each interview, the researcher conducted preliminary research for each foreign company or ministry using reports, financial statements from the companies, or statements from the government regarding FDI and related policies.

The interviews were conducted during the years 2009 and 2010. The foreign companies interviewed were investing in different sectors. The second category of those interviewed were the officials working for the government in the relevant ministries. In most cases, the researcher contacted the interview subjects again post-meeting by email and/or telephone to clarify details necessary to the analysis.

This chapter describes the research methodology including the population, sample and data collection instruments, as well as strategies to ensure the ethical standards, reliability and validity of the study.

The chapter is divided into the following sections: firstly it discusses the research methodology. The second and third sections discuss the formulation of the research design, its process and the strategy laid out. Then the chapter discusses the quantitative and qualitative research methods in the methods section. Also in this section, a summary of the data analysis research methods is discussed.

## **5.2 QUALITATIVE AND QUANTITATIVE RESEARCH**

### **5.2.1 Qualitative Research**

Qualitative research generally involves examining meanings, feelings and reflections on perceptions (Kumar, 1999). According to Denzin and Lincoln (1994), qualitative research focuses on the interpretation of phenomena in their natural settings to make sense in terms of the meanings people bring to these settings. Qualitative research involves interviews, observations, historical observations, interactions and visual texts which are significant moments and meaningful in people's lives. In terms of data analysis, qualitative research is more narrative and descriptive in nature (Kumar, 1999). Patton (2002) defined qualitative research as attempting to understand the unique interactions in a particular situation. The purpose of understanding is not necessarily to predict what might occur but rather to understand in depth the characteristics of the situation and the meaning brought by participants and what is happening to them at the moment. The aim of qualitative research is to truthfully present findings to others who are interested in what you are doing.

### **5.2.2 Quantitative Research**

Quantitative research is a formal, objective and systematic process in which numerical data are used to obtain information about the world. This research method is used to describe variables, to examine relationships among variables, and to determine cause and effect between variables (Burns & Grove, 2005).

It is normally used for conducting deductive reasoning research (Bryman & Bell, 2003). Several techniques including frequency distribution, cross-tabulation, factor analysis, and other statistical procedures could be used for the data analysis (Kumar, 1999).

Chapter Seven in this thesis has explored the development and importance of FDI in Sudan. The broad objective was to examine the impact of the FDI flows on the macroeconomic of Sudan in term of its positive and likely negative effects. To address these impacts, data drawn from secondary and primary sources is used for the purpose. The statistical package Linear Regression Model was used to obtain the results under evaluation.

In Chapter Nine the study examines the impact of China's investment in Sudan in terms of its positive and likely negative effects; data drawn from secondary and primary sources is used for the purpose. Tabular analysis is used to review the scale of operations of the investing firms. An understanding of the behaviour and motivations of these firms is gauged in the light of Dunning OLI framework.

To explain the importance of Chinese oil and non-oil investment compared to foreign oil and non-oil investment in Sudan, this thesis uses quantitative secondary data on the share of China's oil and non-oil investment, relative to total foreign oil and non-oil investment in Sudan over the period 1997-2010.

Consequently, this thesis employs a combination of quantitative and qualitative research methods in order to provide a comprehensive analysis of the impact of government policies on FDI in Sudan.

### **5.3 RESEARCH DESIGN**

According to Collis and Hussey (1997), the research process consists of six stages as follows:

Stage 1 involves identifying the research topic. Initially, the idea for this thesis resulted from several factors, one of which was the lack of detailed research on the subject of FDI in Sudan. Interest in this subject arose from the researcher's interest in the subject of political studies of international trade and the globalisation of trade. As a part of a postgraduate study in political science, the researcher focused upon the trade liberalisation effect on Sudan and the efforts of the Sudan to join the WTO. He read extensively on the topics of international trade and FDI. Finding from a previous research have led the researcher to understand the impact of FDI on the development and the policies implemented by governments to attract FDI. In the meantime, Sudan had taken measures to attract FDI. Since Sudan is highly interested in FDI as the best source of development finance, it is important to study the economic reforms and the impact of these reforms on FDI.

Stage 2 involves defining the research question. A thorough analysis of both the theoretical and applied literature on FDI was undertaken. It also concerned literature on revealed FDI and economic growth. In addition, an investigation of the existing literature that specifically focused on the FDI in developing countries and FDI in Sudan was carried out. This literature review guided the researcher in outlining the main research questions.

Stage 3 involves determining the research planning. As has been discussed, a range of approaches was used to address the research questions. In doing so, Sudanese officials working for the government, academics and research institutions in Sudan were contacted in order to facilitate the fieldwork. The fieldwork that was carried out involved interviews and a survey with foreign investors.

Stage 4 involves collecting information and research data. At this stage, a process of collecting data and important information was initiated, and selected research methods were applied. Data on macroeconomics for Sudan and developing countries were collected from international organisations such as UNCTAD, the World Bank and the

IMF, Central Bank of Sudan, government reports and online database. Interviews with people with expertise on issue were carried out and a survey on the FDI trends, sources and volume conducted.

Stage 5 involves data analysis and interpretation. Data and information that were collected in Stage 4 were analysed and evaluated. The results from the interviews and the questionnaire survey, and the empirical findings of study all provided evidence in answering the research questions.

Stage 6 contains the conclusions and recommendations which will provide data and information for policy makers in Sudan.

## **5.4 RESEARCH METHODS**

According to Clifford Wood (1927), research comprises defining and redefining problems, formulating hypotheses or suggested solutions, collecting, organising and evaluating data, making deductions and researching conclusions, and, finally, carefully listing the conclusions to determine whether they fit the formulated hypothesis. Research defines as systematised effort to gain knowledge (Kumar, 1999).

Research methods are understood as all those methods and techniques that are used for conducting of research. Research methods or techniques thus refer to the researcher's use in performing research operations. In other words, all those methods which are used by the researcher during the course of studying his research problem are termed as research methods, and research methodology is a way to systematically solve research problems. In it, we are studying the various steps that are generally adopted by a researcher in studying his research problem so it is not only the research methods but also the methodology. Research methodology has many dimensions and research methods constitute a part of a research methodology.

The researcher in this study used several methods in order to examine the idea in depth and cover all the issues involved. In this study, the researcher combines qualitative and quantitative research methods. These methods include interview surveys, a questionnaire and index analyses. The combination of methods is called mixed method, multiple method or the triangulation methods.

### **5.4.1 Quantitative Research Method**

In this study, the quantitative research methods involved questionnaire surveys in order to understand inflows of foreign capitals to Sudan by foreign investors or by partnership with the host countries, and whether these investments directly contributed to making tangible changes in the economic position of the country.

This method also entails collating statistical data in order to analyse FDI to developing countries and to Sudan, and the macroeconomic climate of Sudan.

#### **Quantitative Data Collection**

Secondary data for this study were collected from a number of institutions and annual reports. These included the Ministry of Foreign Trade, Ministry of Investment, Ministry of Energy and Mining, Central Bank of Sudan annual report, the International Trade Centre database, the United Nations Commodity Trade Statistics database, the World Bank database, the IMF database, and the WTO database.

The questionnaire survey was used as one of the tools to collect information for this research. The survey, which was entitled ‘Foreign investors doing business in Sudan’ was carried out to assess the volume of FDI in Sudan and the effects of the investment law and the FDI policies on the foreign investors.

Questions in a questionnaire survey can be open-ended or close-ended. The former allows the respondents to provide any answer that they believe appropriate. Close-ended questions, however, refer to questions that are already coded and allow the respondent to quickly pick an answer from number of pre-determined options.

In designing the questions in this survey, both the close-ended question style and open-ended questions were utilised.

#### **Validity and Reliability**

A much cited definition of validity is that of Hammersley (1987); ‘An account is valid or true if it represents accurately those features of the phenomena, that it is intended to describe, explain or theorise’. Polit and Hunger (1993) refer to reliability as the degree of consistency with which an instrument measures the attribute it is designed to

measure. The validity of an instrument is the degree to which an instrument measures what it is intends to measure (Polit & Hunger, 1993).

In quantitative research, particularly in a questionnaire, the validity depends on the accuracy, honesty, and correct response from the respondents who complete the survey (Cohen et al., 2007).

Therefore, to ensure the validity of the questionnaire before distributing it, the appropriate procedures were undertaken and the questions were assessed to make sure that their wording was sufficiently clear to the respondents.

The researcher ensured that he chose the right person; for this study the questionnaire survey was delivered to the director of the related department, those who worked for the government and had responsibility for the business and to the managers of companies in the private sector. The questionnaire in this survey was directed towards two sets of foreign investors. One group consisted of investors experienced with China and the Far East Countries, and the second group consisted of investors from Arab Gulf Countries and Europe.

A list of foreign firms from the database of the Ministry of Investment was compiled prior to distributing the questionnaire. Only those companies with complete contact numbers and email addresses were selected to participate in the survey. The number of companies collected from these sources amounted to more than 1,000. The questionnaire was conducted with foreign investors, who play an important role in investment in Sudan, 375 foreign companies.

### **Questionnaire Administration**

Choosing the study sample is an important step in any research project since it is rarely practical, efficient or ethical to study whole populations. The aim of all quantitative sampling approaches is to draw a representative sample from the population so that the results of studying the sample can then be generalised back to the population. The selection of an appropriate method depends upon the aim of the study.



The size of the sample is determined by the optimum number necessary to enable valid inferences to be made about the population. The larger the sample size, the smaller the chance of a random sampling error; it is inversely proportional to the square root of the sample size, there is usually little to be gained from studying very small samples.

The questionnaire in this survey was directed towards two sets of group. One group consisted of foreign investors and the second group of Sudanese officials, investors, and key personnel in private and public sector.

However, using the method of purposive sample, a type of non-probabilistic sample, allows the researcher to specify the available population by justifying the researcher's judgement as to research interest. This enables the author to satisfy this specific research project (Robson, 2002).

Two major distribution techniques were used in conducting the survey for this study: by hand and by email surveys. 1,197 companies listed in the Ministry of Investment in Sudan were identified as having established a business in Sudan, 375 selected for the questionnaire survey. The number of responses received was 155 in addition to 45 face-to-face interviews. Overall, the total number of responses received was 200.

The researcher had direct meetings with 73 key personnel in the private and public sectors to complete the data about the FDI trend, volume and sources (Chapter Seven). The direct meeting interviews were considerably more successful, in terms of the response rate (Appendices 1, 2 and 3).

### **Data Analysis for the Questionnaire Survey**

The data collected was analysed according to the researcher's best knowledge, 'whatever the nature of the data, the task of interpretation falls squarely on the shoulders of the researcher' (Moser, 1971). After the data was collected, it was organised and analysed. For closed-ended questions, data was analysed by using descriptive statistics. Tables were drawn and, from these, the data was presented and analysed.

After the data have been collected, the researcher turns to the task of analysing them. The analysis of data requires a number of closely related operations such as establishment of categories, the applications of those categories to raw data through coding and tabulation, and then drawing statistical inferences. Researchers should classify the raw data into some purposeful and usable categories.

Coding is usually done at this stage through which the categories of data are transformed into symbols that may be tabulated and counted (Kumar, 2008). Editing is the procedure that improves the quality of the data for coding.

Tabulation is a part of the technical procedure wherein the classified data are put in form of tables and the researcher analysed the collected data with the help of various statistical measures.

The researcher used descriptive analysis for statistical tools. This type of analysis is used to explore the data collected for the study. Descriptive analysis is also used to summarise, organise, and describe the data that have been gathered (Coake, 2005). It is a very useful tool to observe general findings from the survey. Chapter Seven provides questionnaire analysis in the trends and sources of the FDI inflows during 1990 – 2010 to Sudan and to discover the obstacles that foreign investors may have to face while doing business in Sudan.

### **Statistical Analysis**

Secondary data were collected from a number of institutional reports including the World Bank reports, UNCTAD world investment reports, and IMF reports. Economic data were collected from the Central Bank of Sudan, Ministry of Foreign Trade, Oil Corporation and Ministry of Investment. Important statistical databases such as the IMF, World Bank and Sudan Central Department of Statistics database have been used to acquire relevant data for some of its empirical analysis.

### **Linear Regression Model**

In statistics, regression analysis is a statistical process for estimating the relationships among variables. It includes many techniques for modeling and analysing several variables, when the focus is on the relationship between a dependent variable and one

or more independent variables. More specifically, regression analysis helps one understand how the typical value of the dependent variable (or 'Criterion Variable') changes when any one of the independent variables is varied, while the other independent variables are held fixed. Most commonly, regression analysis estimates the conditional expectation of the dependent variable given the independent variables, that is, the average value of the dependent variable when the independent variables are fixed. Less commonly, the focus is on a quantile, or other location parameter of the conditional distribution of the dependent variable given the independent variables. In all cases, the estimation target is a function of the independent variables called the regression function. In regression analysis, it is also of interest to characterise the variation of the dependent variable around the regression function, which can be described by a probability distribution.

Regression analysis is widely used to understand which among the independent variables are related to the dependent variable, and to explore the forms of these relationships. In restricted circumstances, regression analysis can be used to infer causal relationships between the independent and dependent variables (Armstrong, Scott, 2012).

Many techniques for carrying out regression analysis have been developed. Familiar methods such as Linear Regression and Ordinary Least Squares regression are parametric, in that the regression function is defined in terms of a finite number of unknown parameters that are estimated from the data. Nonparametric regression refers to techniques that allow the regression function to lie in a specified set of functions, which may be infinite-dimensional.

The performance of regression analysis methods in practice depends on the form of the data generating process, and how it relates to the regression approach being used. Since the true form of the data-generating process is generally not known, regression analysis often depends to some extent on making assumptions about this process. These assumptions are sometimes able to be tested if many data are available. Regression models for prediction are often useful even when the assumptions are moderately violated, although they may not perform optimally. However, in many applications, especially with small effects or questions of causality based on

observational data, regression methods can give misleading results (David & Freedman, 2005; Cook & Welisberg, 1982).

Linear regression attempts to model the relationship between two variables by fitting a linear equation to observed data. The simple linear regression model is given by:

$$Y_t = \alpha + \beta X_t + U_t$$

Where:

$Y_t$  = the dependent variable

$X_t$  = the explanatory variable

$\alpha$  = the intercept and  $\beta$  = the slope (coefficient of the independent variable)

$U_t$  = residual (error term)

The subscript (t) denotes to the time since  $t = 1, 2, 3, \dots, T$

The most common method used for estimation above model is the ordinary least square (OLS) which aims at minimising the square of residuals. The OLS assumes that the dependent and error term are normally distributed. Also there is no relationship between  $X_t$  and  $U_t$  (Kutner & Neter, 2004; Ravishankar & Dey, 2002).

The quantitative analysis in Chapter Seven involved examining the impact of FDI inflows on economic growth in Sudan. To magnify the impact of FDI on economic growth, and factors determining the inflows and effectiveness of FDI, the researcher uses the Linear Regression Model in estimating the model parameters. It utilises the statistical package Linear Regression Model to obtain the results under evaluation, when the researcher collected data from Central Bank of Sudan. It examines the impact of FDI on the GDP, imports and exports for the period 1994 to 2010.

## **5.4.2 Qualitative Research Method**

### **Qualitative Data Collection**

The qualitative research interview seeks to describe the meanings of central themes in the life and world of the subject. The main task in interviewing is to understand the meaning of what the interviewees say (Kavale, 1996). A qualitative research interview

seeks to understand at both a factual and a meaning level, although it is usually difficult to interview at a meaning level (Kavale, 1996).

A standardised open-ended interview, where the same open questions are asked to all interviewees, facilitates faster interviews that can be more easily analysed and compared; closed fixed-response interviews is where all interviewees are asked the same questions and asked to choose answers from among the same set of alternatives. This format is useful for those not practiced in interviewing.

Apart from the aim of attaining the research objectives, the interview questions were designed to examine the impact of governmental policies on foreign investors and provide insights into some of the key aspects of this thesis. This method of qualitative research was used to discover the obstacles that foreign investors may have to face while doing business in Sudan, and also used to analyse the institutional and governmental contribution to encourage FDI.

### **Interview Administration**

In qualitative research, the sample is small and not chosen randomly. Rather, the choice of a sample is purposeful (Patton, 1996). In a qualitative survey (interview surveys specifically) it is very rare to determine the sample size, as there is very limited knowledge about the population from which the sample is taken. Thus, it is advised that the respondents or informants might be selected according to their relevance to the research topic rather than to whether they represent the population (Cohen et al., 2007).

Therefore, qualitative researchers tend to use non-probability or non-random samples. Examples of non-probability sampling techniques are convenience sampling, quota sampling, purposive sampling and snowball sampling.

For this thesis, group of interviewees from both government and private sectors were chosen according to their expected knowledge on FDI and their relation to the investment field. Interviews with government bodies were specifically conducted by interviewing personnel from the specific department that was focusing on investment in Sudan.

The researcher prepared for the interviews. A list of interviewees was prepared with their contact details. Interviewees were approached by letter (see Appendix 2). Emails were sent to interviewees to explain the purpose of the interview, the format of the interview, an indication of how long the interview would take, and to provide the contact information of the interviewer.

Prior to the interview sessions, the interviewees were informed of the research and the subsequent use of the data. They were also reassured regarding the confidentiality of their information. The interviewees were interviewed using open-ended questions. Notes and key points from the responses were taken, and they themselves were allowed to ask any related questions. After each interview, the responses were manually transcribed into a database allowing the researcher to identify and quickly analyse the themes and trends from the interviews.

As the researcher was satisfied with interviews, qualitative analyses of the results were carried out. Discussions on the interview data analyses are discussed below.

### **Data Analysis for Qualitative Method**

Despite the diversity of qualitative methods, data are obtained through practical interviews. The analysis is based on a common set of principles: transcribing the interviews; immersing oneself in the data to give detailed insights into the phenomena under investigation; developing a data-coding system, and linking codes or units of data to form overarching categories or themes that can lead to the development of theory (Morse & Richards, 2002). Analytical frameworks such as the framework approach (Ritche & Lewis, 2003) and thematic networks (Attride-Sterling, 2001) are gaining in popularity because they systematically and explicitly apply principles of undertaking qualitative analysis to a series of interconnected stages that guide the process.

Generating themes from data is common feature of qualitative methods and a widely used analytical method.

The procedures of analysis for the data collected through qualitative techniques are quite different. Qualitative data will be analysed with content data analysis. This

involves: data preparation and data-entry (transcript); the set-up of some type of classification scheme (codes), and the classification of data by different researchers in order to establish the reliability of the classification scheme. The transcripts are cut and then sorted. Each segment gets a code. Conclusions are made on the basis of this classification or further analysis in which relations are examined between different codes.

## **5.5 CONCLUSION**

The researcher used a qualitative and quantitative method. Questionnaires were administered by the researcher to collect the data from convenient samples. The questionnaires had both closed-ended and open-ended questions. The samples characteristics included those key personnel in both private and public sector. A group of interviewees from both government and private sectors were chosen according to their expected knowledge on FDI and their relation to the investment field. Interviews with government bodies were specifically conducted by interviewing personnel from the specific department.

The researcher describes the method applied in researching this thesis. In conducting this research, a combination of qualitative and quantitative methods have been employed here. The case study approach has been chosen to investigate the measures taken by the government of Sudan to encourage FDI and whether there has been any significant growth in the amount of FDI according to the influence of public policies on inward FDI flows. The sampling procedure is described, followed by the means of data collection. Methods of data analysis and limitations of the research are discussed. Finally, the framework for this research is introduced.

## **Chapter 6**

# **ECONOMIC POLICIES AND FOREIGN TRADE IN SUDAN**

### **6.1 INTRODUCTION**

Governments in developing countries are increasingly looking for best practice policies regarding FDI. Renewed confidence in the positive benefits of FDI has led many countries to be more open towards FDI in the 1990s and beyond. Sudan Governments is liberalising FDI regimes as they associate FDI with positive effects on economic development and poverty reduction in the country. Increased liberalisation and technological advances have led to a rapid growth in FDI flows and FDI has gained in its share of domestic investment and GDP in Sudan.

This aim of this chapter is to investigate the Sudanese foreign trade regime, and examine its relation to the policy of liberalisation, the impact of these policies on the Sudanese economy, and the result of these policies in the performance of the economy. This chapter firstly discusses the economic background of Sudan by providing the economic performance. Secondly the chapter focuses on the economic policies that have been implemented to drive economic development and attract FDI flows to the country. The researcher finds that, as a result of the measures taken by the government, economic performance has improved in real terms.

### **6.2 ANALYSIS OF ECONOMIC POLICIES**

GDP per capita in Sudan grew 46% in the 1960s, reaching a peak growth of 170% in the 1970s. But this proved unsustainable and growth consequently scaled back to 34% in the 1980s. Finally, it grows again after the 1990s. Until the early 1970s, Sudan's agricultural output was mostly dedicated to internal consumption. In 1972, the Sudanese government became more pro-Western, and made plans to export food and cash crops. However, commodity prices declined throughout the 1970s, causing economic problems for Sudan. At the same time, debt servicing costs, from the money spent mechanising agriculture, rose. In 1978, the IMF negotiated a Structural Adjustment Program with the government. This further promoted the mechanised



export agriculture sector. This caused great economic problems for the pastoralists of Sudan.

During the late 1970s and 1980s, the IMF, World Bank, and key donors worked closely to promote reforms to counter the effect of inefficient economic policies and practices. By 1984, a combination of factors, including drought, inflation, the confused application of Islamic law, reduced donor disbursements and capital flight led to a serious foreign-exchange crisis and increased shortages of imported inputs and commodities. More significantly, the 1989 revolution caused many donors in Europe, the US and Canada to suspend official development assistance, but not humanitarian aid.

However, as Sudan became the world's largest debtor to the World Bank and IMF in 1993, its relationship with the international financial institutions soured in the mid-1990s and has yet to be fully rehabilitated. The government fell out of compliance with an IMF standby program and accumulated substantial arrears on repurchase obligations. A four year economic reform plan was announced in 1988 but was not pursued. An economic reform plan was announced in 1989 and began implementing a three year economic restructuring programme designed to reduce the public sector deficit, end subsidies, privatise state enterprises, and encourage new foreign and domestic investment. In 1993, the IMF suspended Sudan's voting rights and the World Bank suspended Sudan's right to make withdrawals under effective and fully disbursed loans and credits. Lome Funds and EU agricultural credits, totaling more than one billion Euros, also were suspended.

Since the late 1970s, the Sudanese economy has experienced continued deterioration characterised by: (1) weakness in production and productivity; (2) disequilibrium in internal and external balances; (3) rapid increase in the rate of inflation and low standards of living; (4) devaluation of the national currency; (5) heavy external debts; and (6) unequal distribution of income and wealth among individuals and regions (Sudan Strategic Report, 2000).

When the present government took over in 1989, the first item on its agenda was economic deterioration (Sudan Strategic Report, 2000). It was very evident that potential economic policies would draw their reasoning from Islamic ideology.

Islamic ideology, like capitalism, respects free dealings, private ownership and non-intervention in supply and demand (Ali, 1999).

In previous years, the government was satisfied with the then available official inflows from regional and international institutions, and also grants, loans and technical assistance. Since then, however, the US continued its negative policy regarding Sudan, and, moreover, Sudan came to be considered a country which hosted terrorism, abused human rights, and the government of which was responsible for the war in the South. All these reasons and others led to a direct stoppage of US and European grants and assistance from an annual level of US\$ 500-800 million to about US\$ 50 million in 1998, and then to almost nothing in 1997 (Ali, 1999). Therefore, Sudan found that there was no alternative except to take measures to open the economy to the private sector and to attract large capital inflows and encourage FDI.

The Sudanese Government has adopted a number of economic reforms to arrest the deterioration (Sudan Strategic Report, 2000) as contained in the Comprehensive National Strategy (CNS, 1992-2002). The main objective of the CNS is to liberalise the economy to enable economic activities to be mainly determined by market forces (Bank of Sudan 38<sup>th</sup> Annual Report, 1998). Consequently, prices have been liberalised, and import/export restrictions have been abolished. Moreover, a more liberal law encouraging investment has been promulgated, an extensive privatisation and restructuring programme for public enterprises has been implemented, and the multiple and overvalued exchange rate has been replaced by a floating rate (World Bank Memo, 2003). In its endeavour to liberalise trade, the Government has taken numerous measures including the removal of quantitative restrictions on imports, and the simplification of tariff procedures and structures.

Sudan continues to strengthen links with key emerging country partners, especially China, Malaysia and India following the attraction of substantial 'resource-seeking' FDI from these countries since the late 1990s. The oil sector has contributed significantly to economic development. A peaceful conclusion to the North-South separation process is critical for sustaining oil production and for protecting the stock of committed oil-related FDI. This is also an important catalyst for attracting further

resource- and market-seeking FDI, and for paving the way to normalising relations with key global players, particularly the United States and the European Union.

As a result of reforms implemented since 1992, the real GDP increased by 7.3%, 9.4% and 4.7% for the years 1994, 1995 and 1996, respectively (Bank of Sudan 36<sup>th</sup> Annual Report, 1996). In 1999, GDP increased by 3.4% and, in 2000, by 4.7% (Bank of Sudan 40<sup>th</sup> Annual Report, 2000). According to the World Bank report updated in April 2009, the GDP for the year 2002 was US\$ 13.5 billion.

These policies, which were meant to influence demand and activate the supply side attracted the attention of the IMF (Ali, 1999), and therefore relations with Bretton Woods institutions improved. Sudan's progress from 1997 to 2009 with the IMF Staff Monitored Program was one of the important factors that contributed to Sudan's reinstated voting rights at the IMF in 2000 (World Bank Memo, 2009).

### **6.3 BUSINESS ENVIRONMENT**

Sudan is endowed with diversified natural resources, by Sub-Saharan African standards, and has always been facing the challenge of productive utilisation of such resources to embark on sustained growth and structural transformation. In the period 1960-2007, the growth of trend real GDP alternated remarkably between negative and positive growth over 1960-1973 and 1974-2010 respectively. The trend growth for the whole period is positive and significant. The ill-designed policy programmes, natural disasters and the entrenched civil conflicts and unrest, *inter alia*, provided explanations for such dismal performance and waste of opportunities (Ali & Elbadawi, 2002).

This sagging growth record, except the oil-driven growth period which is still plagued by notable income inequality and increased poverty, has been mirrored by changing political regimes and ideologies. A shifting emphasis on relative roles of private and public investments in the economy has thus recurred with varying political doctrines and orientations. Following a prolonged era under colonial British rule and a development policy geared towards availing raw materials (cotton) for manufacturing sector at home, the state emerged predominantly at the country's independence investing heavily in the agricultural sector, which accounted for around 61% of real

GDP. The role of private capital in developing the economy was acknowledged by the first national government. In 1956, the Approved Enterprise Concessions Act was introduced to encourage domestic and foreign private businesses. However, the role of private foreign capital was adversely affected by the October revolution in 1964. Although the socialist slogans at the time were not articulated in state policy, foreigners started to liquidate their businesses and hence the flow of foreign investment was discouraged. By early 1969, these socialist slogans were formally adopted; all commercial banks were nationalised along with more than 70 major corporations.

The experience of the abortive left wing coup in 1971 triggered a reversal of direction; nationalisation was rolled back with a view to broadening participation in the development process. Following the constitutional change at the time, the economy comprised the public, cooperative, private and mixed sectors, and later legislation and policies regarding foreign investment in the 1980s and 1990s were considered within this framework. This new tendency to improve investment legislation and restore the confidence of foreign investors facilitated the inflow of FDIs in the early 1970s. The upsurge of these foreign investments was also encouraged by the then recently signed Addis Ababa peace agreement and the 1971 oil price hike which precipitated huge Arab surpluses. The Foreign Companies Registry shows that, between 1971 and 1983, 150 such companies were registered. Notably, a number of oil firms were attracted, e.g., Chevron, Total, Eastern Texas, Union Texas and Sun Oil. In 1978, Chevron discovered oil in its region of concession and, by the time of developing the Unity and Hejilij oil fields to exploit an estimated 250 m/b reserves, the second civil war broke in 1983. The oil factor was integrated into the many causes of this civil war. Chevron's installations and oil fields became a target for attack and, as a result, operations were suspended by 1984.

Despite the fact that FDI during 1971-83 was relatively small in quantity compared to other types of international capital inflows, official project assistance, humanitarian aid and adjustment programme lending, most notably in its operation in the form of foreign firms, marked a significant qualitative transformation (B. Ahmed, 1986).

Virtually no significant FDI inflow was recorded between 1984 and 1995, due to intensification of the civil war and the associated political instability; for example, the period witnessed four changes of political regime. However, the investment climate was improved to a great extent following the application of macroeconomic reforms initiated in 1992. The divestiture of numerous public enterprises was an integral part of the reform. The technical committee for the disposal of public enterprises listed 117 SOEs for privatisation, of which 57 were privatised between 1992 and 1997 (Suliman, 2007). A new Investment Encouragement Act was introduced in 1996, amended in 1999 and 2001. By 2002, a Ministry of Investment was established as one-stop-shop bringing together diversified, but project related authorities: Land Authority, Customs Authority, Tax Chambers and Commercial Registrar. Its mandate includes firm licensing, construction permits and firms import licensing. The sealing of the Comprehensive Peace Agreement, provided an enabling environment for these reforms. The achieved political and economic stability was the foremost requirement for mitigating business risks and the alleviation of fears of foreign investors about a revival of investment policy and laws.

## **6.4 COUNTRY INFRASTRUCTURE**

Sudan has a developed infrastructure compared to most of Sub-Saharan Africa and many projects are taking place to develop it even further all across the country. Some parts of the country are better off, mainly in the northern states due to oil production and the wealth gained from it. The telephone system in Sudan is well equipped by regional standards, and is maintained by modern standards. One of Sudan's greatest projects was the Merowe Dam. Khartoum was rewarded by being named the Arab Capital of Culture in 2005. Modern buildings in Khartoum are on the rise due to the economic growth and due to the FDI inflow to the real estate sector.

As a result of increased public investment in infrastructure, the national road network and electricity generation have improved but many parts of the country, particularly conflict areas in the South and Darfur, suffer from a severe infrastructure deficit, even by national standards. Poor infrastructure means higher production costs and constrains opportunities for broad-based, non-oil growth. At the same time, the authorities face tremendous challenges in providing public services, particularly

education and clean water, to these areas, due to financial constraints and insecurity in some cases. Sudan has had limited access to external financing from donors and multilateral financial institutions over the last two decades.

Sudan has 4,725 kilometers of narrow-gauge, single-track railroads that serve the northern and central portions of the country. The main line runs from the north on the Egyptian border to Khartoum and southwest to the southern border of the country, with extensions to the west of the country. Other lines connect the north and the west with Port Sudan. A 1,400-kilometer line serves the al Gezira cotton-growing region. A modest effort to upgrade rail transport is currently underway to reverse decades of neglect and declining efficiency.

Sudan is seeking to expand its installed capacity of electrical generation of around 300MW, of which 180MW is hydroelectric and the rest thermal. European investors, considering the continuing US economic, trade and financial sanctions regime, are the most likely providers of technology for this purpose. More than 70% of Sudan's hydropower comes from the Roseires Dam on the Blue Nile grid. Various projects are proposed to expand hydropower, thermal generation, and other sources of energy, but so far the government has had difficulty arranging sufficient financing. A new dam established in Merowe was opened in 2008 and generates 1250MW of electricity.

With the majority of its manufacturing firms and irrigated land concentrated in the northern states of Khartoum and Gezira, the World Bank reports that there is a large disparity in development indicators between the best and worst performing states. Sudan's capital city Khartoum consumes nearly a third of Sudan's total electricity production. Sudan's industrial development consists of agricultural processing and various light industries located in Khartoum North. In recent years, the Giad industrial complex introduced the assembly of small autos and trucks, and some heavy military equipment such as armored personnel carriers and the main battle tank. Sudan is reputed to have great mineral resources, exploration has been extended to different areas, and the country's real potential is relatively unknown. Some quantities of asbestos, chromium and mica are also exploited commercially.

## **6.5 OBJECTIVES OF ECONOMIC POLICIES**

The targeted goals for the economic sector in Sudan are as follows: (1) to attain justice and equality; (2) self-reliance and full mobilisation of Sudan's natural and human resources; and (3) the adoption of economic policies aimed at the liberalisation of the national economy, adherence to market mechanisms and enhancement of the role of the private sector, bearing in mind that such policies necessitate the privatisation of state-owned enterprises, elimination of price control and subsidies and the adjustment of the exchange rate (Sudan Strategic Report, 2000). Prices of goods and services have been liberalised and are freely determined by market forces, and subsidies to consumer goods have been eliminated.

The economy in Sudan is a mixed one. The state-owned sector includes water supply, electricity, enterprises, railways, airways, certain industries (including sugar, textiles, tanneries, etc.), agricultural schemes, banks and other financial institutions. More than 85 enterprises, including commercial banks and companies, factories, agricultural projects, tourism, insurance, hotels and communication were privatised in the period 1990-2002 through direct sales, public shareholding, rent and restructuring. Sectoral policies play an important role in increasing production and rates of productivity. These policies aim mainly to: (1) increase the marginal efficiency in productive units; (2) promote efficient use of resources and minimisation of losses in the production process; (3) promote efficient use of production inputs to minimise cost; and (4) encourage fair distribution of wealth.

The financial budgetary and fiscal policies implemented in Sudan aim mainly at realising the following objectives: (1) increasing production in all sectors of the economy; (2) mobilising local resources and encouraging inflow of foreign resources; (3) eliminating the budget deficit and refraining from resorting to deficit financing; (4) curtailing the role of the public sector and managing government-owned corporations and companies on a sound commercial basis; (5) liberalisation of the economy and price control; and (6) reducing dependence on indirect taxes as a main source of revenue by tapping new sources (Bank of Sudan 40<sup>th</sup> Annual Report, 2000).

## **6.6 POPULATION GROWTH**

In the last two decades Sudan has experienced high population growth, accompanied by an increasing rate of poverty. Since 1990, the population has grown from 24.9 million to the current count of 38.6 million, with a fertility rate of 4.5. Politically, the ethnic differences within the country have been one of the predominant sources of internal conflict, causing active warfare for the last 24 years, and leaving hundreds of thousands of people displaced or at risk of extreme violence.

Based on the United Nations Population Fund's estimate, the population in Khartoum State is currently increasing by 4.04% each year. This is a far more rapid increase than has ever occurred in the different Sudanese states. The two elements that regulate population growth are birth and death rates. The question then is whether a slowdown in population growth will be a result of a decrease in births or an increase in deaths. If the population continues to grow without bounds, nature will take over and the death rate will rise to solve this. Examining the beginning of the population increase in Sudan's case, it can be seen that there were many factors which caused it to grow. With the expansion of industry, individual families were able to emigrate to the country's capital; this caused excessive growth from being able to afford more children. In addition, increases in knowledge about nutrition and medicine helped to produce healthier babies. When women take care of their bodies better, they are more fertile and therefore can have more children. Also, with cures for fatal diseases including antibiotics and vaccines, more children are able to live longer. Finally, there has been an increase in fertility due to a number of factors including a reduction in the average age at which menarche occurs and an increase in the number of menstrual cycles a woman has in her lifetime. These types of changes seem good for society, and they are in the sense that more people mean more development for Khartoum society.

Population information for Sudan has been limited but, in 1990, it was clear that the country was experiencing a high birth rate and a high, but declining, death rate. Infant mortality was high, but Sudan was expected to continue its rapid population growth, with a large percentage of its people under 15 years of age, for some time to come. The trends indicated an overall low population density. However, with famine



affecting much of the country, internal migration by hundreds of thousands of people was increasingly occurring. The United Nations High Commissioner for Refugees reported that, in early 1991, approximately 1.8 million people were displaced in the northern states, of which it was estimated that 750,000 were in Khartoum State, 30,000 each in Kurdufan and Al Awsat states, 300,000 each in Darfur and Ash Sharqi states, and 150,000 in Ash Shamali State. Efforts were underway to provide permanent sites for about 800,000 of these displaced people. The civil war and famine in the south was estimated to have displaced up to 3.5 million southern Sudanese by early 1990. In addition to uncertainties concerning the number of refugees, population estimates were complicated by census difficulties. Since independence, there have been three national censuses; in 1955-56, 1973, and 1983. The first was inadequately prepared and executed. The second was not officially recognised by the government, and thus its complete findings have never been released. The third census was of better quality, but some of the data has never been analysed because of inadequate resources. The 1983 census put the total population at 21.6 million with a growth rate between 1956 and 1983 of 2.8% per year. In 1990, the National Population Committee and the Department of Statistics put Sudan's birth rate at 50 births per 1,000 and the death rate at 19 per 1,000, with a rate of increase of 31 per 1,000 or 3.1% per year. This is a staggering increase when compared with the world average of 1.8% per year and with the average for developing countries of 2.1% per year, this percentage made Sudan one of the world's fastest growing countries. The 1983 population estimate was thought to be too low, but even accepting this and the pre-1983 growth rate of 2.8%, Sudan's population in 1990 would have been well over 25 million.

## **6.7 LABOUR FORCE GROWTH**

It is commonly understood that the demand for labour is derived from the demand for goods and services. Often, when real rates of GDP are high, demand for labour takes the same pattern. Sudan is considered one of the top five countries in the world in achieving growing GDP/real rate of growth. During the period 2000-2007, the average real rate of growth was around 7.6% which is considered the third highest rate in the world; however, demand for labour did not grow at the same rate compared with other countries on the list of fastest growth. This was mainly attributed to the fact

that the excessive growth in the GDP/real rate of growth is a consequence of the increase in oil production and prices. The mass of the Sudanese labour is concentrated in agricultural activities where growth in the sector is marginal; the increase in GDP is therefore less effective on impacting total labour growth. When the main sector sheds workers, even relatively fast employment growth in subsidiary small sectors is not sufficient to generate fast employment growth overall.

In the long-term, growth in productivity will be essential to generate employment growth but, currently, there is a possibility of trade-off in productivity growth and employment. Creation of new job opportunities in services will lead to growth in employment in this sector, as Sudan is witnessing very high demand in agricultural investment, which will automatically lead to lack of services investment as an integrated business.

Given the inherited dual structure of the economy it is perhaps not surprising that a dual labour market has continued to exist in the period since independence: a fairly large market in the rural, traditional, sector and a small, but growing, urban modern market. The rural labour market is perceived to be largely competitive, or flexible, with self-employment as the dominant form of employment. The urban labour market started as a protected market, but has experienced increasing flexibility since the late 1970s.

The latest detailed information on the labour market is available from the migration and labour force survey (Ministry of Manpower, 2000). The information shows that the rural labour market accounted for 69% of the total labour force of age ten years and above, and for the employment of about 71%. In terms of the gender composition of the labour force it is found that, of the total labour force, 69% were male; 75% for the urban sector, and 65.7% for the rural sector. According to official statements, there have been no major changes to the ratios since that time.

The results imply that women's involvement in economic activity is higher in rural areas, an expected result given the agricultural nature of the economy and its stage of development.

A major characteristic of the total labour force is its low educational achievement.

Thus, of the total labour force, approximately 43% had no education (13.4% for the urban sector and 56% for the rural sector); 19.5% could not read and write (13.7% for the urban sector and 22% for the rural sector); 11.8% had primary education (14% for the urban sector and 10.8% for the rural sector); 12.8% had secondary education (29.8% for the urban sector and 5.3% for the rural sector); and 5.3% had university and higher education (15.6% for the urban sector and 0.7% for the rural sector). The educational levels of the employed labour force were almost identical to those of the total labour force. As would be expected in a developing country such as Sudan, there are substantial gender differences in the educational levels of the labour force (and the employed labour force). Without becoming involved in details, suffice it to note that, of the employed labour force, those with no education represented 34.9% of the employed males compared to 65.9% of the employed females.

The distribution of employed labour in addition to those who had previous labour market experience but were unemployed at the time of the survey (about 90% of the labour force) over the three conventional production sectors was such that the primary sector accounted for 55.3% of employment, with the services sector accounting for 38.7% and the secondary sector for only 6%. In the urban sector, 82.9% of the employment was accounted for by the tertiary sector, with 12.3% for the secondary sector and 4.8% for the primary sector. By contrast, in the rural sector, 76.6% of employment was accounted for by the primary sector, 20% by the tertiary sector and only 3.4% by the secondary sector.

The distribution of employed labour according to ownership of the sector of work was such that the private sector accounted for 75% of employment, the government sector accounted for 17.4%, and the public enterprise sector accounted for 3.1%, with the remainder employed in cooperative and other unidentified sectors. The pattern of employment in the urban sector closely followed the overall picture, albeit with different shares reflecting the importance of government sector employment. Thus, in the urban areas, the private sector accounted for 52.3% of urban employment, with the government sector accounting for 39.2% and the public enterprise sector accounting for 4.5%. By contrast, the employment pattern in the rural areas was such that the private sector accounted for 84.6% of total employment, while the government sector accounted for 8.2% and the public enterprise sector for 2.6% of total employment.

This pattern of employment in the rural sector is consistent with the overall perception of the rural labour market as being more flexible, or competitive, compared to the urban labour market.

Related to the above feature of the labour market is the distribution of employed labour according to the duration of work contracts. According to the survey results, 42.5% of employed labour had permanent employment, with seasonal employment accounting for 48.3%, and occasional and temporary employment accounting for 10% and 1.2% respectively. In the urban labour market, permanent employment accounted for 80.2% of the employed labour, with occasional employment accounting for approximately 13% while seasonal and temporary employment accounted for 5.5% and 1.2% of urban employment respectively. By contrast, in the rural labour market, permanent employment accounted for 26.7%, while seasonal employment accounted for 63.5%, with occasional and temporary employment accounting for 8.7% and 1.1% respectively. Once again, this goes to confirm the perception of the rural labour market as being relatively more flexible than the urban labour market.

Another important feature of the labour market is that 84.1% of the employed labour was found to be working in establishments of a very small size (defined as employing between one and nine workers). Employment in small enterprises (employing between ten and 29 workers) accounted for 7.8%, that in medium enterprises (30-49 workers) accounted for 1.2% and that in large enterprises (employing 50 workers and more) accounted for 7% of the total. In urban areas very small enterprises accounted for the employment of 65.8% of the total.

In rural areas very small enterprises accounted for the employment of 91.8% of the employed rural labour force with small, medium and large enterprises accounting for 4.5%, 0.4% and 3.3% respectively. Of the total employed labour, the survey results showed that only 35.8% were working for a wage. Those working for a wage in the urban sector accounted for 71.9% of the employed urban labour force while those in the rural sector accounted for 19.5% of the employed rural labour force. In a sense therefore, wage employment seems to be limited, which implies a small size for the labour market as it is properly understood. Using the survey results, it can be shown that the average monthly wage in 2000 amounted to US\$ 19.6 in the rural sector and

in the urban sector amounted to US\$ 73.3, thus implying an urban-rural wage differential of 1.9 per month. Needless to note that the average wage rate in the rural sector was below the international poverty line of US\$ 30 per person per month, while that in the urban areas is slightly above this poverty benchmark. There is evidence to show that these estimates are reasonable compared to the wage rates in the government sector in 2000. Thus, according to the Ministry of Finance and National Economy Report (2000: 36-37) the highest monthly wage in the government sector, after taking into account all types of allowances, amounted to US\$ 52.6 while the lowest monthly wage amounted to US\$ 8.1. These figures vary greatly from 2008 figures, indicating that the lowest salary by law was SDG (Sudanese Pound) 200 (equivalent to US\$ 89.69) and there was no limit for the highest salary depending on the nature of the job. There is also evidence that, over time, real wages have declined. With declining real wages and the limited size of the labour markets, one would have expected the labour market to achieve a natural rate of unemployment of about 5%. According to the Ministry of Labour's report (2008), the rate of unemployment increased from approximately 5.5% in 1973 to 16.6% in 1996 and to 22% in 2008, recording an annual rate of increase of 5.2%.

The rural unemployment rate is lower than that of the urban sector but is still relatively quite high, with a tendency for the rate of unemployment to increase with the level of education, although the pattern of increase is not uniform. In the urban sector, the highest unemployment rate is recorded for the intermediate level of education, with the university level ranking second.

Meanwhile, in the rural sector there is a clear tendency for the rate of unemployment to increase up to the primary level and then decline. The behaviour of the overall unemployment rate mirrors that of the urban sector.

The fact that the unemployment rate has increased at a rate of 5.2% per annum over the period 1973-2008 can be taken as a failure of the growth process to generate sufficient employment opportunities. A response to the then emerging economic crisis was undertaken by individuals in the form of migration to the Gulf oil producing countries. As a result of the first oil price increase these countries started ambitious development programmes and, as such, created a regional labour market to which

labour flocked from all over the world; the same situation is happening now in Sudan after the increase in oil production. No exact numbers of Sudanese Nationals Working Abroad (SNWA) was ever reported in the relevant literature or the official sources. However, a number of field survey studies were conducted at the time and fairly believable and consistent time series data were constructed. According to these estimates, the number of emigrants increased to approximately 350,000 from the year 1984 and stabilised thereafter. As would be expected, such an emigration process was highly selective in terms of educational levels, skill levels and age groups.

Thus, for example, in 1983, a comparison of SNWA with labour in terms of skills showed that 0.4% of SNWA were highly trained administrators compared to 0.2% for the labour force; 9% were professionals compared to 3%; 7% were clerks compared to 2.4%, and 4.3% were unskilled workers compared to 11.9%. In terms of educational level, only 16.6% of SNWA were illiterate compared to 68% of the labour force; 32.4% had primary education compared to 6%; 17% had intermediate level education compared to only 2.1%; and 26% had secondary or higher qualifications compared to 4.8% in the labour force. Indeed, in 1983, it was officially reported that, out of 5,815 medical doctors, 2,254 left the country (a ratio of 39%); out of 2,640 engineers, 950 migrated (a ratio of 36%); and out of 1,665 trained teachers, 965 opted to migrate (a ratio of 58%). The growth of employment in Sudan was not at all hindered by the cost of labour, as payment for the workforce is considered very low compared with other Arab countries, and low salaries imposed less of an adverse burden because government decided to lower payroll taxes. The unemployment rate, the degree of informality in the labour market and the extent to which the minimum wage affects the informal sector are all factors that could affect the extent to which the employer contribution to payroll taxes are actually paid by the workers through low salaries.

The impact of fiscal policies on labour market, workforce and wages will be discussed in the coming chapter and are difficult to predict, but the sustained growth followed by this policy will lead to long-term employment generation.

For the short-term, authorities need a comprehensive job creation strategy that includes physical capital accumulation, human capital accumulation and productivity growth. This strategy will be the only option for the federal government to adopt in

order to ameliorate the current labour situation that is expressed in Table 6.1.

**Table 6.1: Growth in Labour, 2000-2007**

<b>Year</b>	<b>Workforce in millions</b>	<b>Employed in millions</b>	<b>Unemployment %</b>
2000	9.2	7.8	17.9
2001	9.7	8.3	16.8
2002	10.1	8.5	18.8
2003	10.4	8.7	19.5
2004	10.7	9	18.9
2005	11	9.2	19.6
2006	11.5	9.5	21.1
2007	12.1	9.9	22.2

*Source:* Ministry of Labour and Human Resources Development

Table 6.1 shows that the rate of unemployment, excluding the year 2001, is increasing compared with the base year of 2000, which means that there is a surplus of supply which may be of good use to new investments.

Basically, the problem of unemployment may be attached to either supply or demand. In practice, however, it is not possible to exert any effort regarding the supply side because employment seekers are the only ones to determine their lack of labour. So, labour supply grows steadily and policymakers head for the advantage of employment creation as a means of income distribution. The only way to generate real supply side potential is to increase the growth of labour demand in the long run by creating new activities.

It is widely believed that increasing the supply of skilled labour, for instance, will produce a strong expansionary effect on employment generally, through increased absorption of unskilled labourers; following this assumption, the Sudanese educational authorities decreed the expansion of university study in all aspects via expansion of universities in the different states. The number of university graduates increased rapidly, creating an abundance which increased the unemployment problems. Since the potential for correcting the labour market's disequilibrium by working on the supply side is a limited policy, it is necessary to concentrate on the demand side of the equation. The desirability of accelerating the creation of

productive employment should be evident, taking into consideration labour reallocation.

Large real estate projects in Sudan, such as Al-Noor City of Kuwait, Yassmien of Egypt, Misherib of Qatar, and their main competitors, will definitely help to reduce the percentage of unemployment in the workforce, especially in the casual labouring sector, and implementing such new cities will attract jobseekers and help the process of reallocation of labour. Finally, the surplus of labour supply will offset the growing demand resulting from new real estate investments.

## **6.8 SUDAN ECONOMY FEATURES AND PERFORMANCE**

### **6.8.1 Gross Domestic Product**

In recent years, Sudan has had stable economic growth. Consequently Sudan's real economic growth average reached around 9% during 2005-2006, putting Sudan among fastest growing economies in Africa (WB, 2008). Table 6.2 expresses the growth in the GDP in different sectors.

The agricultural sector includes sub-sectors of irrigated agriculture, rain-fed agriculture, forestry, livestock and fisheries. The industrial sector includes the following sub-sectors; oil, mining and quarrying, manufacturing and handicrafts, and the electricity and water sector. The services sector includes the following subsectors; building and constructions, real estate, transport and communications, financial intermediation services, and non-profit households.

**Table 6.2: GDP at Constant Prices (SDG millions)**

<b>Sector</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Agriculture & Livestock	28,454.7	31,190.8	35,985.5	38,480.6	38,529.6	49,958.8
Industry	18,835.3	22,978.9	34,238.0	38,272.3	38,321.3	45,112.3
Services	38,417.1	44,122.2	49,613.7	58,758.8	58,808.1	67,132.8
GDP	85,707.1	98,291.9	119,837.2	135,511.7	135,659.0	162,203.9

*Source:* Central Bank of Sudan



GDP growth registered more than 10% per year in 2006 and 2007. Sudan's economy boomed on the back of increases in oil production, high oil prices, and large inflows of foreign direct investment. Sudan's oil production began in the late 1990s and grew rapidly starting in July 1999. Sudan produced an estimated 401,000 barrels per day (b/d) in 2005, which brought in about US\$ 1.9 billion, provided 70% of the country's total export earnings and benefited the other sectors of the economy. As of 2007, oil production in Sudan was at 466,100 barrels per day. In 2010, oil accounted for over 90% of Sudan's foreign exchange earnings.

Gold, mining and quarrying have contributions to make to GDP. Sudan opened the country's first gold refinery and it is speculated to be one of the largest such constructions in Africa. The refinery will produce more than 328 tons of gold annually. The refinery will also be able to process silver and its opening should reduce the amount of gold and silver smuggled to other markets. As a measure of actual sale prices, GDP does not capture the economic surplus between the price paid and subjective value received, and can therefore underestimate aggregate utility. Table 6.3 illustrates GDP at constant prices.

**Table 6.3: GDP at Constant Prices (SDG millions)**

Sector	2009			2010		
	Value	Growth rate %	Share %	Value	Growth rate %	Share %
Agriculture and Animal Resources	8.6	6.7	30.8	9.2	6.7	31.3
Petroleum	2.3	2.8	8.3	2.2	5.1	7.5
Mining and Quarrying	0.1	9.3	0.2	0.1	9.3	0.2
Processing and Handicraft	3.0	7.9	10.7	3.2	8.0	11.0
Electricity and water	0.7	9.1	2.4	0.7	9.1	2.5
Building and construction	0.9	10.2	3.2	1.0	10.2	3.3
Trade and Hotels	2.2	6.7	7.8	2.3	6.7	3.3

Sector	2009			2010		
	Value	Growth rate %	Share %	Value	Growth rate %	Share %
Transport and Communications	2.7	7.6	9.6	2.9	7.7	9.8
Finance and Real Estate Services	3.3	4.4	11.7	3.4	5.5	11.7
Community and Social Services	0.3	6.0	1.2	0.4	6.0	1.2
Financial Intermediation	1.6	0.6	1.6	0.4	6.0	1.6
Government Services	3.8	3.1	13.5	3.8	1.6	13.0
Households Services	0.2	1.3	0.7	0.2	1.3	0.8
Import Charges	0.4	6.0	1.5	0.4	1.6	1.4
GDP at Constant Prices	28.0	5.9	100	29.4	5.2	100
GDP Deflator	4,853.5			5,516.6		
GDP at Current Prices	135,659.0			162,203.9		

*Source:* Ministry of Finance and National Economy

The agricultural sector is considered one of the main sectors in the Sudanese economy, as most of the population depends on it for the provision of food and raw materials for local industries, and for job opportunities, in addition to its substantial contribution to exports. Despite the small increase in its percentage contribution to GDP from 30.8% in 2009 to 31.3% in 2010, it continued to be the leading sector in GDP. Its growth rate remained constant within the limits of 6.7%. This was attributable to the rise in the growth rate of irrigated agriculture, forestry and others, as well as traditional rain-fed agriculture.

The relative contribution of the agrarian sub-sector to the agricultural sector as a

whole stood at 51.1%. The growth rate of this sub-sector contributed to the increase in the growth rate of this sector from 13.4% in 2009 to 15.9% in 2010. Meanwhile, the animal sub-sector contributed 48.9% of the total share of the agricultural sector in 2009 and 45.3% in 2010 (Bank of Sudan Report, 2011).

This contribution is highlighted due to the importance of this sector in the total non-petroleum exports. The increase of the amount produced will increase the quantities for export, which will result in an increase in export logistics which, in turn, will add to the balance of payments and secure re-transference of capital and projected returns. In the industrial sector, the growth rate of the manufacturing and handicrafts sector increased slightly from 7.9% by the end of 2009 to 8% by the end of 2010, while the growth rate of the mining and quarrying remained at 9.3% and electricity and water sector was at 9.1% by the end of 2010.

The growth rate of the real estate sector increased from 4.4% by the end of 2009 to 5.5% by the end of 2010, the transport and communications sector from 7.6% by the end of 2009 to 7.7% by the end of 2010, along with the rate of growth of the building and constructions sector remaining constant at 10.2%, the financial intermediation services 6%, the non-profit households at 1.3% and the trade, hotels and restaurants at 6.7%. And the decrease in the growth of the government services was from 3.1% by the end of 2009 to 1.6% by the end of 2010.

It is important to note the way in which the GDP real rate of growth has been developing during the past years. The increase shown in the growth rate derives from government activities to establish a strong economy through foreign investment, and this was the true situation that attracted foreign investment to enter the Sudanese virgin markets. Table 6.4 expresses the aforesaid situation and gives clear progressing economy benchmarks.

**Table 6.4: GDP Real Rate of Growth**

<b>Year</b>	<b>Growth rate %</b>
2001	6.1
2002	6.5
2003	6.0
2004	7.2
2005	8.6
2006	9.3
2007	10.2
2008	6.0
2009	5.9
2010	5.2

*Source:* Bank of Sudan Annual Reports

The table shows clearly that the real growth rate started to escalate from the year 2005, based on the improvement in oil production and price development in real estate investment. Even if agricultural products were doubled in the year 2008, this would not lead to an improvement in the rate of growth, which was expected to drop in the years 2008 and 2009 as a result of recent global economic crises.

### **6.8.2 Foreign Trade**

The government's foreign trade policy during 2007 continued to focus on expanding the national export base in general and non-oil exports in particular, in addition to strengthening competitiveness and opening new markets, as well as the development of the traditional markets.

In the context of encouraging intra-region trade among the Common Market of East and Southern Africa Countries (COMESA), Sudan continued the practical application of zero tariffs with some member countries of this regional organisation.

### 6.8.3 Sudan: Direction of Imports and Exports

As for imports, Table 6.5 below shows the direction of import sources and every market share of foreign production imports. This will obviously determine the selection of the appropriate companies to deal with and the vessels to take their agency for inland logistics. Countries of Asia and Western Europe are best to investigate and the same vessels calling at these ports are the best target.

**Table 6.5: The Direction of Imports**

Country	Value in US\$ million			As % of total imports		
	2005	2006	2007	2005	2006	2007
Western Europe:	1,179.7	1,404.0	968.7	17.46	17.39	15.55
Germany	81.2	0.0	0.0	1.20	0.00	0.00
Italy	257.6	271.6	222.7	3.81	3.36	3.58
Netherlands	93.4	109.1	88.8	1.38	1.35	1.43
Belgium	37.9	42.2	24.0	0.56	0.52	0.39
Sweden	82.0	96.4	78.0	1.21	1.19	1.25
Spain	15.0	21.4	18.7	0.22	0.27	0.30
Others	170.0	182.5	140.4	2.52	2.26	2.25
Eastern Europe:	346.5	331.0	258.8	5.13	4.10	4.1
Russia	57.5	0.0	0.0	0.85	0.00	0.00
Turkey	154.7	206.3	165.7	2.29	2.56	2.66
Ukraine	95.1	87.9	68.5	1.41	1.09	1.10
Bulgaria	14.0	7.4	4.5	0.21	0.09	0.07
Czechoslovakia	3.0	0.0	0.0	0.04	0.00	0.00
Others	22.2	29.4	20.1	0.33	0.36	0.32
Asia:	2,560.1	3,522.5	2,623.5	37.89	43.63	42.12
Japan	341.8	535.8	267.3	5.06	6.64	4.29

<b>Country</b>	<b>Value in US\$ million</b>			<b>As % of total imports</b>		
China	1,383.0	1,679.4	1,469.1	20.47	20.80	23.59
India	317.8	599.0	349.2	4.70	7.42	5.61
Bangladesh	14.8	17.8	10.8	0.22	0.22	0.17
South Korea	149.8	335.4	224.5	2.22	4.15	3.60
Others	367.7	372.9	313.4	5.45	4.62	5.03
Africa:	560.2	628.9	606.9	8.29	7.79	9.74
COMESA Countries	466.8	595.0	568.7	6.91	7.37	9.13
Other African Countries	93.4	33.9	38.2	1.38	0.42	0.61
Western Hemisphere:	460.6	489.5	398.5	6.82	6.06	6.40
US	129.7	104.0	131.6	1.92	1.29	2.11
Brazil	54.3	149.7	77.3	0.80	1.85	1.24
Others	276.6	235.8	189.6	4.09	2.92	3.04
Middle East:	1,364.2	1,366.8	1,108.2	20.19	16.93	17.79
Saudi Arabia	627.5	649.3	501.5	9.26	8.04	8.05
UAE	394.8	444.7	394.6	5.84	5.51	6.34
Jordan	45.3	54.1	57.7	0.67	0.67	0.93
Syria	46.8	38.9	30.9	0.69	0.48	0.50
Others	249.6	179.8	123.5	3.69	2.23	1.98
Australia	221.8	223.1	141.0	3.28	2.76	2.26
Other Countries	63.7	107.7	122.4	0.94	1.33	1.97
Total	6,756.8	8,073.5	6,228.0	100.0	100.0	100.0

*Source:* Central Bank of Sudan Annual Report 2008

It is also important to highlight the details of imports by commodities which constitute the major source for supply logistics. The reason for giving details for such imports is

to allow for logistics specialisation and to give a clear idea regarding the contribution of each commodity in the imports and how it moves from year to year. Table 6.6 clearly illustrates the imports.

**Table 6.6: Sudanese Imports by Commodities**

Commodity	Total imports value in US\$ million			As percentage of total imports		
	2005	2006	2007	2005	2006	2007
Tea	37.0	35.2	36.3	0.55	0.44	0.44
Animal and vegetable oils	33.3	32.8	59.6	0.49	0.41	0.73
Machinery and equipment	1,971.9	2,810.5	3,071.5	29.18	34.81	37.38
Coffee	26.3	36.4	34.4	0.39	0.45	0.42
Wheat and wheat flour	383.6	341.7	376.3	0.30	0.52	4.58
Lentils	20.4	41.6	35.1	0.30	0.52	0.43
Other food stuffs	310.2	258.1	294.8	4.59	3.20	3.59
Drinks and tobacco	42.5	47.7	54.7	0.63	0.59	0.67
Medicines	145.7	174.7	218.5	2.16	2.16	2.66
Other chemicals	348.1	315.8	37.3	5.15	3.91	4.52
Petroleum products	322.0	414.2	242	4.77	5.13	2.94
Other raw materials	104.5	138.2	109	1.55	1.71	1.32
Manufactured goods	1,627.9	1,640.8	1,711.2	24.19	20.32	20.84
Transport equipment	1,149.7	1,490.5	1,293.3	17.02	18.46	15.74
Textiles	233.7	295.3	307.1	3.46	3.66	3.74
Total	6,756.8	8,073.5	8,214.9	100.00	100.00	100.00

Source: Ministry of Foreign Trade

Regarding exports, the Table below (6.7) reflects the direction of Sudan's exports and its percentage of total exports during 2006, compared to 2005.

**Table 6.7: Direction of Exports by Value, 2005 and 2006 (US\$ million)**

Importers	2005		2006	
	Value	Total export %	Value	Total export %
Asian Countries (except Arab Countries):	4,155.2	86.1	4,872.8	86.1
China	3,427.1	71.0	4,243.9	75.0
Japan	577.5	12.0	522.6	9.2
India	30.8	0.6	22.5	0.4
Singapore	5.8	0.1	16.0	0.3
South Korea	7.9	0.2	6.2	0.1
Other Asian Countries	106.1	2.2	61.6	1.1
Arab Countries:	377.8	7.8	549.6	9.7
UAE	90.0	1.9	227.4	4.0
Saudi Arabia	136.4	2.8	126.4	2.2
Egypt	78.7	1.6	96.8	1.7
Yemen	10.8	0.2	44.2	0.8
Syria	12.7	0.3	18.0	0.3
Lebanon	42.5	0.9	17.3	0.3
Other Arab Countries	6.7	0.1	19.5	0.4
European Countries:	140.3	2.9	102.2	1.8
European Union Countries	109.8	2.3	61.3	1.4
United Kingdom	21.8	0.4	19.0	0.3



Importers	2005		2006	
	Value	Total export %	Value	Total export %
Other European Countries	8.6	0.2	21.8	0.1
US	12.3	0.3	49.0	0.1
Other Countries	138.7	2.9	127.2	2.3
Total	4,824.3	100.0	5,656.6	100.0

*Source:* Central Bank of Sudan & Sudan Customs Authority

Asian (non-Arab) countries constituted the largest market for Sudanese exports (especially oil) during 2006, standing at US\$ 4,872.8 million, i.e., 86.1% of the value of exports, compared to 71 % in the previous year. China, whose imports of Sudanese exports stood at US\$ 4,243.9 million, representing 75.0% of the value of exports, topped the list of the importing countries, followed by Japan, whose imports of Sudanese goods reached US\$ 522.6 million, constituting 9.2% of the total value of exports. During 2006, the value of Sudanese exports to Arab countries witnessed an increase as their value reached US\$ 549.5 million, i.e., 9.7% of total exports, compared to 7.8% in 2005.

The United Arab Emirates (UAE) ranked first with total imports of Sudanese goods of US\$ 227.4 million or 4.0%, followed by the Kingdom of Saudi Arabia with total imports of US\$ 126.4 million, i.e., 2.2% of the total Sudanese exports. Exports to European countries declined from US\$ 140.3 million in 2005 to US\$ 102.2 million in 2006, a decline of 27.2%. The European Union countries topped the list of countries importing Sudanese goods, with a total value of US\$ 76.5 million and a percentage share of 1.8%, followed by the United Kingdom and other European countries with a total value of US\$ 19.0 million and US\$ 6.7 million, i.e., 0.3% and 0.1% of the total value of exports, respectively. On the other hand, the proceeds of exports to the US registered a decline from US\$ 12.3 million in 2005 to US\$ 4.9 million in 2006. Since petroleum exports have a separate channel, the consideration of market share will be discussed in the following pages.

#### **6.8.4 Fiscal Policy**

In economics, fiscal policy refers to government attempts to influence the direction of the economy through changes in government taxes, or through spending (fiscal allowances). It is the use of government spending and revenue collection to influence the economy.

Fiscal policy can be contrasted with the other main type of economic policy, namely monetary, which attempts to stabilise the economy by controlling interest rates and the supply of money. The two main instruments of fiscal policy are government spending and taxation. Changes in the level and composition of taxation and government spending can impact on the following variables in the economy: (1) aggregate demand and the level of economic activity; (2) the pattern of resource allocation; and (3) the distribution of income.

Fiscal policy refers to the overall effect of the budget outcome on economic activity. The three possible stances of fiscal policy are neutral, expansionary and contractionary.

A neutral stance of fiscal policy implies a balanced budget where  $G = T$  (Government spending = Tax revenue). Government spending is fully funded by tax revenue and overall the budget outcome has a neutral effect on the level of economic activity.

An expansionary stance of fiscal policy involves a net increase in government spending through rises in government spending, or a fall in taxation revenue, or a combination of the two. This will lead to a larger budget deficit or a smaller budget surplus than the government previously had, or a deficit if the government previously had a balanced budget. Expansionary fiscal policy is usually associated with a budget deficit.

A contractionary fiscal policy occurs when net government spending is reduced either through higher taxation revenue or reduced government spending or a combination of the two. This would lead to a lower budget deficit or a larger surplus than the government previously had, or a surplus if the government previously had a balanced budget. Contractionary fiscal policy is usually associated with a surplus.

### **6.8.5 Recent Economic Policies**

The fiscal policies in Sudan are derived from the adoption of economic liberalism, which requires the following:

- To simulate the macroeconomic policy for all economic activities, the Bank of Sudan expects to move to inflation targeting. However, there is a concern that monetary policy, which targets inflation, can have an adverse effect in a high debt economy with a high proportion of debits denominated in foreign currency and market concern about debit sustainability. Furthermore, since Sudan adopted Islamic Laws, the bank cannot carry out a policy to increase interest rates in order to lead to decrease in inflation. So fiscal policy went in the direction of decreasing aggregate demand and output through real appreciation, which succeeded in reducing the inflation rate drastically.
- The simulation finds that the encouragement of foreign investment and increase of domestic investors, especially in the field of business, results in a significant decrease in inflation.
- Fiscal adjustment has been the cornerstone of Sudan's stabilisation and crisis recovery programme. Sudan has achieved a relatively high rate of growth each year and this has underpinned the growing credibility of the programme. However, there has been concern about the quality of fiscal adjustment. One source of this concern is the argument that revenue adjustments are less than expenditure adjustments, which are more likely to be revised. This was typically what happened in the 2008 budget. The benefit of the adjustments will be in favour of foreign investors.
- The nominal exchange rate, which was depreciating every year, has now arrived at stability and the real exchange rate is appreciating. Contraction in the GDP leads to reduction in domestic absorption and hence a substantial improvement in the current account occurs.
- A combination of an increasing lending rate outside Sudan and tax-induced price increases of formal sector investment goods reduces investment demand strongly. Lower levels of investment lead to lower levels of production capacity and reduce the marginal product of other factors of production in the private formal sector. The Sudanese fiscal policy eliminated this risk by the

increasing credibility of fiscal policy which reduced the effect on foreign investors who were forced to face outside lending rates.

The laws governing investment adhered fully to fiscal policy. Privileges stated in the policy were expressed in the investment encouragement law, tax regulation and customs law. Foreign investors will be treated exactly like domestic investors and have the right to move out their foreign proceeds without any restrictions.

#### **6.8.6 Future Economic Policies**

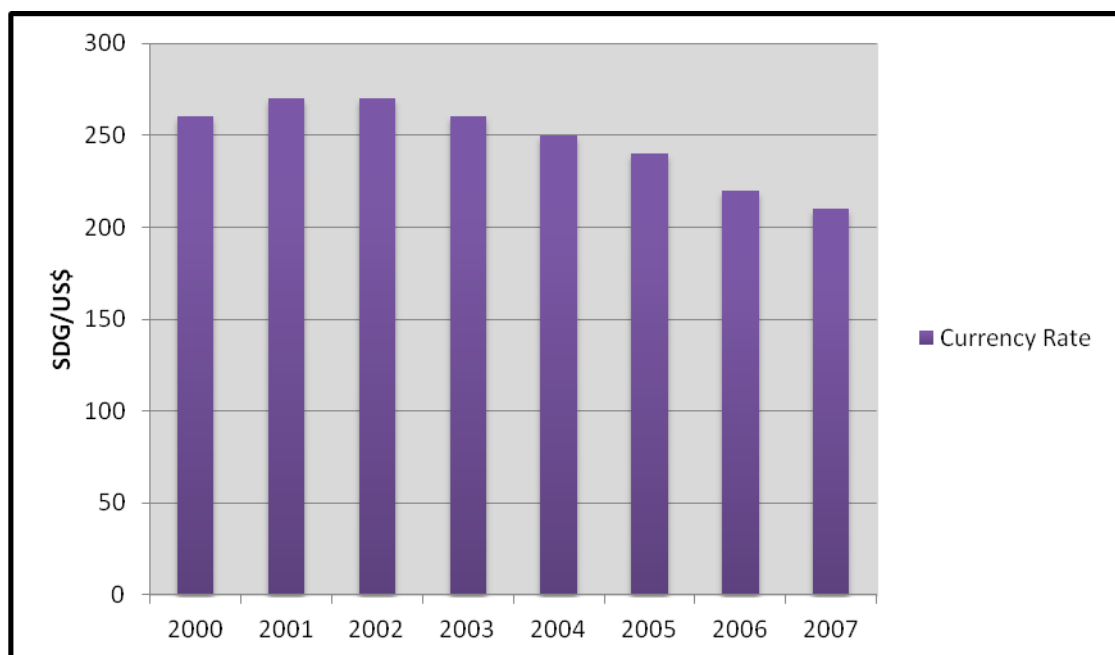
Sudan has implemented economic policies that aim to maintain economic stability and foster growth. Sudan is committed to maintaining macroeconomic stability and advancing the reform agenda, especially in fiscal and financial reform, to tally with the IMF measures. This will be through a process of economic integration under the support of international multinational instruction and development partners. Sudan's government has endeavoured to maintain its focus on enabling high levels of growth with low inflation, benefiting from the substantial increase in oil production. A number of important structural reforms were completed in 2007 as a reflection of this. In 2008, the budget facilitated a notable improvement expressed by steps made with respect. In renewing tax exemptions and improving tax administration the most outstanding examples are: (1) the investment encouragement act has been amended to halt the granting of new task-law; and (2) restoring confidence in public financial management is a central objective of 2008 fiscal policy. Given the difficulties that have emerged in the past from a mismatch between expenditure commitment and available resources, the government adheres strictly to the fiscal stance outlined in the 2008 budget.

As for the balance of payments, the external current account deficit was expected to drop to 7% of GDP in 2008 compared with 11% in 2007. In addition to the sustained surge in international oil prices, non-oil exports are expected to rise due to significant investment in the agriculture sector this year. The Bank of Sudan will continue its plan to restructure the banking system and will probably ask for time-bound action plans from the problem banks to accumulate sufficient provisions to reduce non-performing loans and raise their capital adequacy ratio. This step will lead to a strong banking system and will facilitate investment in Sudan from foreign banks.

### 6.8.7 The Exchange Rate

One of the main factors that attracts foreign investment is stability in the rate of exchange with regard to vital international currencies. As of the year 2000, fluctuations in the Sudanese local currency started to emerge as a result of the fiscal policy which led to adoption of the SDG rate as shown in Figure 6.1 below:

**Figure 6.1: SDG Exchange Rate in Sudan**



*Source:* Central Bank of Sudan

The stability of the Sudanese currency rate favoured both investors and importers which provide goods and services in terms of deferred payment. Since no variations affect the exchange rate, debits will have the same value when settled. Also, investors will have the assurance that their initial investment is fully secured and no losses regarding potential devaluations will sink their funds. Since 2004, the currency exchange rate has lain between SDG 2.00 and SDG 2.50 and, since 2006, the exchange rate was below SDG 2.10 for each US dollar. This situation lasted even after the Central Bank of Sudan shifted from the dollar to the euro. The official exchange rate maintains the same level, although the global economic environment is

facing drastic problems that may lead to deflation if swift corrective measures are not launched. The currency exchange rate stability is much associated with inflation and both have a reciprocal effect on each other. When inflation is high, the rate of exchange fluctuates, and vice versa.

#### **6.8.8 Inflation**

Inflation remains a serious problem in the less developed countries, and a sustained increase in the rate of monetary expansion in excess of the desired increase in the total real balances leads to continuous increase in price levels. Unresponsiveness of prices to economic conditions and demand shocks affects real activity; the continued underlying inflation pressures will be exacerbated. This is mainly attributed to difficulties in supporting the sustained upward movement in average price levels with effective measures of domestic financial restraint. Therefore, large scale liberalisation, when subsidies are reduced, should accompany financial policies that prevent a spiral of initial and future price increases.

Much effort was exerted to combat inflation through pulling down excess demand. Stiff and rigorous programmes were put in place, freezing the key elements such as prices, wages and the official exchange rate; through these vigorous programmes, Sudan succeeded in achieving a high degree of economic stabilisation.

The most appropriate media for inflation was through monetary policies that increased the volume of legal reserve by the Bank of Sudan. The aim for this was to support a lower stock of money which automatically led to a reduction in the credit expansion multiplier. In addition to this, the central bank undertook another method through credit ceiling limitations, which provided a degree of control over growth in domestic components of monetary supply.

Table 6.8 shows how the efforts exerted by Bank of Sudan pulled down the rates.

**Table 6.8: Rate of Inflation**

<b>Year</b>	<b>Rate of inflation %</b>
1998	46.7
1999	16
2000	8
2001	9.4
2002	8.3
2003	7.7
2004	8.4
2005	8.5
2006	7.2
2007	8

*Source:* Bank of Sudan

## **6.9 ROLE OF SUDAN'S GOVERNMENT IN REDUCING RISKS AND ATTRACTING FOREIGN FLOWS**

The investment policies seek to create an appropriate investment environment conducive to the enhancement of production for consumption and export by: (1) providing investment information and streamlining registration and licensing procedures; (2) encouraging the financial institutions to finance the required investment, and (3) reducing government interventions and preventing the formulation of monopolies and protecting consumers (Ministry of Investment Prospects, 2002). Investors, both foreign and domestic, enjoy the same rights and privileges, as stipulated in the Encouragement of Investment Act 1996.

In February 1992, Sudan adopted a liberal trade and economic policy to create the conditions necessary for a functional market economy based on free, fair and open competition. This policy necessitated the abolishing of export-import licensing and of

price controls, the improvement of the foreign exchange system, and privatisation (Bank of Sudan 37<sup>th</sup> Annual Report, 1997).

In fact, after independence, the first investment act was promulgated in 1956. Since then, investment laws have been continuously amended, in 1967, 1972, 1974, 1980, 1990, 1996, 1999 and 2000 (Ministry of Investment Prospects, 2002), with each round introducing new articles with the intention of making the law more permissive. However, the frequent changes in the agencies responsible for investment licensing did not encourage sufficient FDI.

The FDI flows reached a serious and sizeable level gradually after the adoption of the liberalisation policies which, together with removal of subsidies and cancellation of the administrative pricing policy, largely opened the economy and encouraged investors to enter Sudan (Ali, 1999). If one considers the capital that flowed during 1992-2002 in cash or in the form of machinery and equipment, such flows amounted to 73 billion Sudanese SDG (Ali, 1999), with the net flows amounting to US\$ 2,495 million. These flows remain relatively high and had never taken place in Sudan before.

Some of the major foreign investments approved during the last five years are in the following sectors: (1) oil production and refining; (2) electricity generation; (3) petro-chemical manufacture, and (4) transportation (WTO Sudan Accession 6).

### **6.9.1 Role of Sudan's Government in Reducing Risks**

It is important to build the confidence and the trust that the private sector – whether Sudanese or foreign investor – has in the government's ability to cement in an overall environment where: (1) property rights are protected; (2) viability of infrastructure projects, characterised by long lifecycles, is assured, where private equity or long term borrowings are secure, and revenue flows are assured if the private sector is to manage or own an asset; (3) regulatory or other government decisions are predictable, certain and consistent over time; (4) government institutions are transparent and accountable regarding the decisions they take; (5) contractual terms, once agreed to, are enforceable by all parties through an independent judiciary, and (6) the capacity to



put together, evaluate, manage and monitor private public partnership infrastructure projects is present within both government and private sectors.

The Government of Sudan is the most significant factor in determining the risk profile of a country for the foreign investor. Foreign investors usually face two types of risk in addition to the normal commercial risks they are used to managing: these are regulatory risk and country risk.

### **Regulatory Risk**

Foreign investors are looking for a regulatory environment that provides near certainty or, at least, clarity on the rules and their ability to derive some return from their operations. Simplicity is also a positive factor for both Sudan and foreign investors. Both local private operators and foreign investors are likely to suffer from the same institutional weaknesses as the government and have a particular inability to handle overly complex regulations. Without some certainty about the regulatory environment in which they are operating, foreign investors are unlikely to invest.

As regards the content of regulations, there is often a tension between fostering competition and encouraging new investment; in other words there is a tension between eliminating monopoly rents and attracting FDI. In Sudan, the need to attract more investment is important and policy should focus less on eliminating rents and more on providing a favourable environment for investors. Policy should be less concerned with restricting foreign investors' behaviour where the country has need of the services in question.

### **Country Risk**

All foreign investors face risk in-country. Country risk is reduced when conditions in the country and its prospects improve. There are a myriad of factors that change a country's risk profile, including fiscal policy, incidence of corruption, crime and growth. However, Sudanese policymakers can improve country risk by getting a risk rating done by an international ratings agency. This demonstrates openness on the part of the government and will provide an unbiased source of advice for current and future investors.

Policymakers may also counteract country risk by quickly implementing legislation that protects property rights. The right of foreign investors to repatriate profits, for example, is particularly important. In addition, clarity on land ownership is crucial to both local and foreign investors, and can make or break new projects. Generally, making sure that contracts are subject to legal process encourages participants.

### **6.9.2 Growth in Trade in Goods and Services**

Foreign trade plays an important role in Sudan's economy (Suliman, 2001), since export earnings, among others, are considered one of the main sources of foreign currencies needed to finance imports. Sudan, like other developing countries, depends on a few primary commodities, which are cotton, oil seeds, livestock, and gum Arabic (Baspar, 2001). The main imports are capital goods, transport equipment and petroleum products. Sudan does not apply any quantitative import restrictions (Bank of Sudan 38<sup>th</sup> Annual Report, 1998).

Since the mid-1990s, merchandise imports have risen faster than exports. The main imports include food, machinery and equipment, vehicles, spare parts, and energy supplies. The composition of imports changed gradually as agriculture production improved. Food imports, mainly wheat and flour, fell from 18% of total imports to 14% between 1994 and 1998 (Bank of Sudan 38<sup>th</sup> Annual Report, 1998), while the import of manufactured goods rose from 29% to 41% during the same period. However, by 2001, food imports had risen to 19% of total imports. The share of oil from total imports fell from 13% in 1999 to 6% in 2001 (Bank of Sudan 41<sup>st</sup> Annual Report, 2001).

The main import partners for Sudan were the European Union, the US, Japan, China, and Saudi Arabia. The main export partners were the European Union, China and Saudi Arabia (Bank of Sudan 36<sup>th</sup> and 40<sup>th</sup> Annual Reports, 1996 & 2000). Sudan is the main producer of gum Arabic, and the country exports approximately 80% of total world exports.

According to the Sudan National Accounts, exports have increased and become diversified; export volumes grew in line with overall GDP during the 1990s (World Bank Memo, 2003). Non-oil export volume (predominantly agricultural commodities)

grew at an average rate of about 11% during 1991-2000. Over the years, there has been a change in the composition of non-oil exports. Traditionally, cotton was most important but, in 1996, cotton was overtaken by sesame, which remains the leading non-oil export commodity today. Other traditional exports such as gold and livestock have also increased at the expense of cotton and gum Arabic.

Exports of oil have triggered large changes in Sudan's external position and relations. In less than two years, oil established itself as the dominant export good (World Bank Memo, 2003). Oil exports rose from zero in 1998 to US\$ 276 million in 1999, accounting for 35% of total exports. In 2000, oil earned approximately US\$ 1.4 billion, accounting for 80% of exports (World Bank Memo, 2003). After more than 20 years of consecutive trade deficits, a surplus was registered in 2000.

The share of the services in the GDP for the year 2002 was approximately 42.5%. The services sector provided employment for approximately 40% of the labour force (World Bank, World Development Indicators, 2004). The main sub-sectors are financial services, producer services, communications, transport and construction, and insurance.

Sudanese public sector regulations are imposed equally on both foreign and domestic suppliers, with very few exceptions, e.g., holding of land, supplying of maritime services, etc. Therefore, foreign suppliers generally enjoy national treatment (WTO Sudan Accession Report 12). For example, in the telecommunications services market, telephone services were wholly provided by the State-owned Telecommunications Public Corporation (STPC). By 1996, STPC was privatised and Sudatel has become the sole provider of fixed telecommunications network in Sudan (WTO Sudan Accession Report 5). Sudatel is a joint venture between the government and the private sector (both local and foreign).

### **6.9.3 Trade-related Investment Measures**

Regarding trade-related investment measures, Article 10 of the Encouragement of Investment Act 1996 stipulates that projects that assist in the development of export capacities of the country might be granted preferential privileges.

A number of corporations, institutions and companies owned by the public sector play a role in the economy (WTO Sudan Accession Report 5). They do not have a monopoly in any sector of trade, and most of them compete with the private sector. Export of irrigated cotton is monopolised by Sudan Cotton Company Limited, a private limited company that is owned by the Farmers Trade Union (WTO Sudan Accession Report 3).

Exports of raw gum Arabic are monopolised by a public concession company. The equity of this company is owned by farmers, previous gum Arabic exporters and the public at large, and it is registered at the Khartoum Stock Exchange. The government does not provide any exclusive or special privileges to these companies (WTO Sudan Accession Report 3).

In September 1993, the incorporation of a new share-holding company was declared, to pioneer Sudan's first attempt to establish free zones. The Free Zones Act 1994 stipulates that: (1) no property, assets or funds shall be nationalised, confiscated, or put under legal supervision except by a judicial order; and (2) an investor has the right to repatriate capital and profits in whole or part at any stage, provided that all obligations are duly met.

#### **6.9.4 Trade in Agricultural Products**

The Sudanese economy has traditionally relied heavily on the agricultural sectors as a source for growth (WTO Sudan Accession Report 4). The government adopted the ten year CNS, and assigned agriculture a leading role as the driving force for economic growth. Reforms connected with this resulted in the liquidation and privatisation of the agricultural production corporations (Baspar, 2001).

All priorities of agricultural policy are focused on agricultural producer support. The main goals are to ensure food security, support low-income farmers and assist them to maintain a sustainable livelihood (WTO Sudan Accession Report 1). Tariffs on agricultural imports are consistently higher than agricultural exports. The period from 1992 to 1995 witnessed a fall in both tariffs (WTO Sudan Accession Report 1).

This support is in favour of the producers of basic agricultural products while non-product-specific support measures support the producers in general. Estimates of product-specific support show that the major agricultural crops (apart from wheat) were consistently taxed. Non-product-specific support shows that producers benefit from subsidies on imported inputs and on the use of domestic resources. The most important subsidies were those on petroleum products (gasoline and diesel oil). Other subsidies on improved seeds and irrigation played a modest role (WTO Sudan Accession Report 1). Generally speaking, the policy mostly responsible for transferring resources from producers is the foreign exchange policy. Over-valuation of the Sudanese Dinar resulted in taxes for producers.

### **6.9.5 Textile Products**

Investment in this sub-sector is estimated at US\$ 1.5 billion (WTO Sudan Accession Report 3). There are approximately 150 factories, including small ready-made clothes enterprises, in this sector. Of these, five factories produce more than 30% of the total output. However, all of these are producing under their designed capacity, and most of the production in this area is for local consumption. Cotton yarn and grey sheeting is also produced, and part of this is exported. The rate of duty on textiles, textile articles, carpets and other textile floor covering is 75%. Exports of cotton yarn are exempted from export duty.

### **6.9.6 Bilateral Trade Agreements**

Sudan has intensified its efforts to build closer ties with trading partners. Efforts to become a member of the WTO have been renewed. Sudan has concluded a number of bilateral economic, technical and trade agreements (Ministry of Foreign Trade Report, 2001), with Arab, African, Asian, European and neighbouring countries. The agreements with the neighbouring countries include provisions for the facilitation of border trade, combating illegal trade and harmonisation of customs documents. Some agreements include such measures for promotion of bilateral trade as exchange of trade information, establishing joint chambers of commerce, and participation in trade fairs.

The Republic of the Sudan is a party to a number of economic integration agreements, both African and Arab. The most significant is COMESA where member countries had agreed to reduce the custom tariff for the COMESA region by 80% as a preference rate to encourage trade among the member states (Statement of Financial Minister, 2002). The COMESA member countries had already established a Trade and Development Bank, Reinsurance Company, and other institutions. Sudan also is a member of the Arab League, the Arab Economic Unity Council, and the Agreements for Facilitation and Development of Trade among the Arab countries where the members are working to establish an Arab Common Market and Free Trade Arab Area (Ministry of Foreign Trade Report, 2001).

Sudan is also a party to the African Economic Community, which aims to establish an African Economic Community. Sudan is not a member of any labour market integration agreement, however. In addition, Sudan is a member of a number of multilateral organisations.

All barriers to intra-regional trade have been removed; neighbouring countries such as Ethiopia, Eritrea and Kenya have announced their interest in buying oil, petroleum products and non-oil commodities (World Bank Memo, 2003). Bilateral trade agreements have resulted in increased trade and more normalised political links, and contributed to improved international relations. For example, relations with Ethiopia have improved; furthermore, diplomatic ties with Uganda were restored in 2001 (World Bank Memo, 2003). These ties also led to a doubling of imports from Egypt and Kenya, and increased exports such as livestock to Saudi Arabia and most Gulf countries.

In 2001, the US decided to end its opposition to the lifting of UN sanctions on Sudan. Diplomatic relations also improved, and the US has increased and upgraded representation in Sudan. Likewise, the United Kingdom has increased representation and upgraded its diplomatic envoy to ambassador. Relations with the European Union have also improved, and the EU announced in 2002 its intention to resume development with Sudan, some 11 years after it was suspended (World Bank Memo, 2003).

## **6.10 CONCLUSION**

Since the early 1990s, Sudan has adopted and implemented liberal economic policy reforms, and the main objective of these reforms has been to liberalise the economy to enable economic activities to be mainly determined by market forces. These economic reforms involve a deep process of economic restructuring, and upholding of private property rights. Sudan is opening its economy to partners in trade and development from all over the globe.

The comprehensive economic reforms and the trade liberalisation undertaken by the government of Sudan are such as to enhance its integration in the multilateral trading system.

The challenge ahead for the authorities is to ensure macroeconomic stability and sustainability of internal and external balances by controlling the fiscal deficit, rebuilding foreign reserves and maintaining low inflation.

## **Chapter 7**

# **DEVELOPMENT AND IMPORTANCE OF FOREIGN DIRECT INVESTMENT IN SUDAN**

### **7.1 INTRODUCTION**

As discussed in Chapter Two, investment, with its comprehensive economic concept, is regarded as one of the significant basic factors for the realisation of economic development, the main catalyst of economic activity because of its direct link with the capital formation and increase in national economy, in production, renewal, development, etc.

Also it clearly reflects the achievement of economic growth rates, the increase in employment opportunities and hence raises the population's living standards (Elsheik, 2001). From this point, the importance of a study of investment and its impacts (qualitatively and quantitatively) is clear, because it actually reflects to what extent national efforts for socio-economic prosperity have succeeded or failed (Khalid, 1998).

This chapter will explore FDI flows to Sudan, provide analysis for the trends and sources of these inflows, and focus on the Investment Promotion Acts introduced by the government. To examine the impact of the FDI on the macroeconomic growth, the statistical package Liner Regression Model is used. Evidence from the questionnaire survey focused on the obstacles that foreign investors may have to face while doing business in Sudan. A conclusion is given at the end of the chapter.

### **7.2 POLICIES TO ATTRACT FOREIGN INVESTMENT FLOWS**

Since its independence, Sudan has witnessed a flow of foreign capital, either in the form of donations, aid or loans with varying conditions, or in the form of foreign investment lead by foreign investors or in partnership with Sudan. These investments directly contributed to making tangible changes in the economic position of the country.



If we follow the history and the course of Sudan foreign investment, we notice that the flow of the foreign capital to Sudan was negatively affected for the first time by the October Revolution in 1964, which toppled the Abboud Regime. That Revolution was a great turning point in Sudanese policy, which depended on the public sector and guarantee of the foreign investments and foreign trade (Khalid, 1993). However, the revolutionary slogans did not result in official policies on the ground, and panicked some foreign investors, who started to liquidate their investments, which led to the creation of an unfavourable climate for the flow of foreign capital to the country.

By early 1971, the Socialistic Resolutions were reviewed, the first of which were the Resolutions of Nationalisation and Confiscation; some new resolutions were issued to return back all confiscated properties and institutions. Committees were formed to evaluate the compensation for the nationalised banks and companies, according to specific objectives to improve the image of Sudan to the outside world, to regain the trust which it had lost and to get out of the economic dilemma in which the country had put itself, because of these very resolutions which had severely shaken the Sudanese economy, and from which it still suffers (Hareer, 1997).

It is worth mentioning that Sudan is regarded as unique in that it undertook the review of such crucial resolutions less than two years from the date of their issuance, a matter which reflects the extent of their negative impact on the national economy.

The Constitution of Sudan 1973 clearly provided some text for investment guarantees, especially against political risks such as nationalisation, confiscation, imposition of guarding, and others. Also the government passed investment laws in the fields of industry, agriculture, economic services, petroleum and minerals. The aim was to regain the foreign investors' trust (The Investment Encouragement Law, 1976).

Then partial policies for the path of economic reform were fixed, based on the market economy and an economic liberalisation philosophy, which paved the way for partial normalisation of relations with the IMF and the regional and international financing institutions. Also, these radical policies mirrored an increasing openness with the outside world, especially with the Arabic countries and the European Union (The Middle East Magazine, 1980).

These developments were supported by the adoption of economic reforms represented by financial and banking reform, removal of subsidisation from goods and commodities, liberalisation of foreign currency, privatisation of public firms, tax reform, and a review of the investment laws to encourage foreign investments, leading to the Investment Encouragement Law 1999, amended in 2000. The regime started to export oil and Sudan became one of the petroleum exporting countries. Also it undertook intensive publicity campaigns for investment in Sudan, inside and abroad: the most important one was the International Investment Gathering, organised by a Lebanese Company in coordination with Sudan government during the period 11-12 March 2002. This was a clear sign to Arab and other foreign investors that Sudan enjoys huge natural wealth and provides good investment opportunities, an image which stimulated the appetite of investors from the Arab countries, the European Union, Turkey, China, Malaysia, Pakistan and South Africa to head to Sudan (Elsheik, 2001).

Political stability and full security are the most important indicators for investment stimulation, so the government instigated negotiations with the opposition bodies and concluded the Comprehensive Peace Agreement on 26<sup>th</sup> January 2005; this was the pivot for the attraction of the foreign investment in Sudan. However, the situation in Darfur is still in need of a solution so Sudan can attract foreign capital to make use of the local resources and achieve development and stability.

Since the earliest years of the 20<sup>th</sup> century, Sudan has witnessed the establishment of some significant agricultural schemes through foreign financing. These efforts in encouraging the contribution of foreign investment, especially for economic development, did not stop; since the dawn of independence, many laws were issued which embodied many franchises and exemptions for the private local and foreign investments.

It is well known that the flow of FDI largely depends on the availability of an attractive investment climate (Elsheik, 2001):

- The state's political regime, its stability and what rights and duties the citizens enjoy.

- The economic system and to what extent the macroeconomic climate is stable, the financial, monetary and commercial policies, and to what extent they are consistent.
- The legal system and to what extent there is consistency in the content and application of legislation in terms of rights and duties; the nature of the legislative systems that govern the investment and trade operations and the harmony between them; the mechanisms for disputes settlement, especially the applied investment and trade conflicts; the legal systems which govern company formation and the enterprises in general, in addition to the judicial system and to what extent it is taken seriously and how quickly it can resolve conflicts.
- The administrative system and its characteristics of efficiency, qualifications, transparency, neutrality, clear measures and fast determination.
- The market volume and the mechanisms that control it, to what extent the provision of the economic materials, the services level and the infrastructure are available.
- The population number and their scientific and cultural awareness, the availability of the workforce, and if it will lead to a general cost decrease.
- The investment incentives and facilities, and guarantees awarded to investors.

As economic policies as a whole represent a main element within the elements of the investment climate, the government gave this area great importance, as represented in a Ten Year Strategic Plan, followed by a Quarter Century Strategic Plan. The result of these economic policies was a clear decrease in the inflation rate to 7% and stability in the exchange rate against the Sudanese Pound was achieved.

### **7.3 DISCUSSION ON THE FEATURES OF INVESTMENT LAW AND ITS EXECUTIVE REGULATIONS**

In this section, the features of the Encouragement of Investment Act of 1999, amended in 2003, and its executive regulations are discussed. This Law aims to encourage investment in projects that achieve the objectives of development plans and investment initiatives of the private sector (national and international), and public and mixed cooperative sector. The Law deals with the following fields:

- Investment in the fields of agriculture, animal production, industry, energy and mining, transportation and communication, tourism and environment, storage, housing real estate and land promotion, contractions, infrastructure, health service, management and advisory services, information technology, etc.
- The law determines and defines strategic as follows:
  - Infrastructure projects and land promotion such as roads and bridges, ports, electricity, dams, communications, energy, health, tourism, information technology services, and water projects.
  - Projects concerned with extraction of seas and underground resources.
  - Industrial, animal and agricultural production.
  - Trans-states projects.
- Strategic projects will be given exemption from business project tax for ten years as started from commercial production. The Minister may give non-strategic project exemption not to exceed five years.
- The strategic project will be given concessions and guarantees to the state projects, as the Minister may give the state project the following concessions:
  - Total or partial exemption from taxes and fees ordered by local law for a period not exceeding five years, the Minister may extend it to another period by the agreement of the state Council of Ministers.
  - Allocation of the land of the project at a supported price.
- Any state or locality should not impose any tax or fees to federally licensed projects during the exemption period, except for some fees for services provided by the state.
- The Law also contains pre-printed concessions for projects characterised by one of the following characteristics: (1) Investment in the less developed areas; (2) Support for export capabilities; (3) Contribution to achieving integrated rural development; (4) Creation of more job opportunities; (5) Encouragement of charitable endowments; (6) Enhancement of scientific and technical research, and (6) Reinvestment in the projects.

### **7.3.1 Investment Guarantees**

The Law determines that guarantees may be given to investment projects which contain promises not to nationalise or confiscate any project, except by a specific law, and with fair compensation. The Law also guarantees not to distress the project or confiscate the money of the project, except by judicial rights. The Law allows the investor to return the money in the case of difficulties facing the implementation or wind-up of the project; also, the investor may re-export the machineries and equipment, vehicles and other tools exported for the project. The Law allows transferring projects and cost of financing or loans by foreign currency after paying the project obligations. The Law also allows import of raw materials and export of products after the project is entered into exporters and importers registration.

### **7.3.2 Regulations of Investment**

In Chapter Four, the Law contains investment regulations which must be met by the investors, for example:

- To get a license for the project from concerned bodies.
- To submit technical and economic feasibility studies.
- To get the approval of concerned bodies in the case of any change in the size or purpose of the project, such as a change in the purpose of land use of the project, totally or partially selling or renting the land.

## **7.4 DISCUSSION ON THE FLOWS OF FOREIGN DIRECT INVESTMENT**

Since the earliest years of the 20<sup>th</sup> century, studies confirmed the existence of significant investment opportunities in Sudan: (1) Large and varied traditional natural resources; about 47 million animal units on about 2.5 million square kilometres of land, most of it arable, and 21 billion cubic meters from the River Nile waters (Abd El-Gadir, 2002); (2) The petroleum and mineral wealth; significant amounts of oil stockpiled and various and many minerals; (3) The human resources; (4) The industry field, and (5) Investment opportunities in the field of infrastructure, e.g., electricity, water, communications, and roads in addition to investments in the field of social care, education and health, with the existence of large and developing consumption

markets. The accession of Sudan to COMESA assisted in the market base expansion, which confirms the existence of successful investment experiments in Kinana, Sudatel, Higlig, among others.

The investment climate in Sudan is reflected in its political stability. The existence of the civil wars, and the continuation of these wars, has an impact on the potential foreign investor, besides the impact of the international and US sanctions.

As for the financial aspects, it initially appears as a non-acceptance of the banking system, but there have been successive improvements resulting from the active supervision of the Bank of Sudan, and the multiplicity of the taxation collection bodies has led to the improvement of the financial system.

Regarding infrastructure, we find that there is a great deficiency in the supply of electricity, roads, clean water and sanitary drainage, but there is a remarkable development in the modern communications net. However, there is overlap and inconsistency in the specialisations, and weakness in the administrative structures.

As for human resources, there are certainly some with a high level of skill and qualifications but most of them are abroad. There is also an expansion in the educational system quantitatively perhaps at the expense of the quality.

Despite these apparent defects, there are still significant investment flows into Sudan. Recently, Sudan had recorded successive increases in the incoming investments volume in the oil sector. This is confirmed by the International Investment Report (UNCTAD, 2007), that Sudan is one of the seven developing countries in which the volume of the incoming investments surpassed the volume of the developmental aid. Also, the report stated that Sudan is classified one of the developmental countries of high performance in the field of incoming foreign investment, including the classified countries in the same group as China and Brazil.

Although the estimated level of FDI in Sudan was about US\$ 600 million in 2001, it is regarded as weak in comparison to the investment capabilities in Sudan, which can absorb large investment flows, if the appropriate conditions are provided (Ministry of Industry, 2002).

The flows reached a serious and sizeable level gradually after the adoption of the liberalisation policies which, together with removal of subsidies, cancellation of the administrative pricing policy, and devaluation, largely opened up the economy and encouraged investors to enter Sudan. If one considers the capital that flowed in during 1995-1999 in cash or in the form of machinery and equipment, such flows amounted to SDG 30 billion, US\$ 3.7 billion, 5 billion Saudi Riyal, 10 million French Franc and 45.5 million Deutsche Mark (Ministry of Investment, 2004). The FDI inflows reached US\$ 6,102 million in 2010 (Bank of Sudan Report 2011). These flows remained relatively high at a level never seen in Sudan before. These FDI flows largely compensated Sudan's economy for that which it lost in the form of grants and technical assistance.

**Table 7.1: FDI Flows to Sudan, 1995-2010**

<b>Year</b>	<b>FDI flow US\$ millions</b>	<b>Increase of FDI %</b>
1995-1999	840	-
2000	392	-
2001	574	46.5%
2002	713	24.3%
2003	1,349	89.2%
2004	1,511	12%
2005	2,305	52.6%
2006	3,541	53.7%
2007	2,436	-31.2%
2008	2,601	6.8%
2009	3,414	31.3%
2010	6,102	78.7%

*Source:* Data of The Investment Department – Ministry of Investment for the year 2011

From Table 7.1, the steady increase of the foreign investment volume is quite clear; where it was US\$ 392 million in 2000, this rate increased to US\$ 3,541 in 2006, then decreased to US\$ 2,436 million in the fiscal year 2007, then increased to US\$ 3,414 in the year 2009. FDI inflows detailed in the Table above show an increasing pattern, especially from 2001 onwards, indicating that FDI into natural resources was very strong because of the increasing prices of oil and minerals. Also, Sudan's FDI percentage of total African FDI inflows is substantial.

The maximum percentage was reached in 2004 and then began to drop, despite the local increase in FDI driven by the oil and gas industry. This means that other African countries attracted more FDI than Sudan, especially in year 2008 which witnessed financial crises erupting from the US. These crises affected the Arab outflow of FDI and hindered the increase of their investments in Africa; the same crises accelerated mergers and acquisitions in other parts of Africa. As an example, Vodafone group (United Kingdom) acquired 80% of Ghana Telecom and there were contributions by Chinese and British banks to South African banks (UNCTAD, 2007).

The percentage of FDI in gross fixed capital formation reached its highest point in 2006, exceeding 65%, then fell drastically in 2007 and 2008, attributed to the policy of encouraging domestic capital formation in areas other than the oil field. This persistent increase in FDI volume in Sudan is attributed to many reasons, of which one is the existence of high returns; the investment opportunities in Sudan achieve high returns, which are usually impossible for the investor to achieve under normal conditions and happen because of the knowledge of foreign investors about the reality of Sudan. The Arab investors and the investors from the developing countries may know the facts about Sudan more than others, a matter which may provide them with the possibility of perceiving the investment climate of the country clearly, away from the reports of the classification agencies and the circulated library information in international circles about Sudan.

In addition to special relations with Sudan, the financing and Islamic insurance institutions (e.g., the Group of the Islamic Bank For Development, including the Arabic Development Institution) are connected by special relationships with Sudan, as they have been transacting with the private and public sectors for more than a quarter



of a century without recording any problems. Also, Sudan has witnessed a rising trend of its share from the flow of investments to developing countries. These shares are reported in Table 7.2.

**Table 7.2: Share of Sudan of FDI in Developing Countries (US\$ million)**

<b>Year</b>	<b>Inflow to developing countries</b>	<b>Inflow to Sudan</b>	<b>% of Sudan inflow of inflow to developing countries</b>
2000	256,000	392	0.2
2001	215,000	574	0.3
2002	175,000	713	0.4
2003	183,000	1,349	0.8
2004	290,000	1,511	0.6
2005	329,000	2,305	0.7
2006	433,000	3,541	0.9
2007	52,900	2,436	0.5
2008	62,000	2,601	0.5

*Source:* World Economic Report 2003, 2006 and 2009

In recent times and in response to the need to provide investor-friendly environment or be left behind in the new wave of global integration, the attitude of many developing countries has changed significantly. They have become more willing to offer numerous financial and non-financial incentives to foreign investors in order to encourage them to increase FDI flows (UNCTAD, 1998). Given the open door policies, the flow of FDI to developing countries has witnessed a rising trend in the last decade. As shown in Table 7.2, FDI flows to developing countries increased to reach US\$ 433,000 in 2006. Also from the table we notice that the Sudan share in foreign investments as a total of the developing countries was 0.2% in the year 2000. In later years, this reached 0.9%. Although this rate is very weak in comparison with the potential capabilities of Sudan and its promising indicators for capital attraction but the flows to Sudan has witnessed a rising trend.

## **7.5 THE IMPACT OF FOREIGN INVESTMENT ON THE MACROECONOMICS OF SUDAN**

### **7.5.1 The Impact of Foreign Investment on GDP, Exports and Imports**

This section examines the impact of FDI inflows on economic growth in Sudan. To appraise the impact of FDI on economic growth, and factors determining the inflows and effectiveness of FDI, Linear Regression Model is used to estimate the model parameters. Using data collected from Central Bank of Sudan, the Linear Regression Model is utilised to obtain the results under evaluation. It examines the impact of FDI on the GDP, imports and exports for the period 1995 to 2010.

The most common method used for estimation above model is the ordinary least square (OLS) which aims at minimising the square of residuals. The OLS assumes that the dependent and error term are normally distributed. Also there is no relationship between  $(X_t)$  and  $(U_t)$  (Kutner & Neter, 2004; Ravishankar & Dey, 2002).

Given the above, the following hypotheses are tested.

Ho1: FDI has no significant impact on GDP.

Ho2: FDI has no significant impact on Exports.

Ho3: FDI has no significant impact on Imports.

**Table 7.3: FDI (US\$ million), GDP, Exports and Imports Sudan**

**(SDG Millions) 1995-2010**

<b>Year</b>	<b>FDI</b>	<b>GDP</b>	<b>Exports</b>	<b>Imports</b>
1995	0.200	4049.74	350.100	617.90
1996	0.400	10478.13	539.100	1327.00
1997	97.90	16137.37	769.500	2573.00
1998	370.70	21935.91	1007.00	4134.00
1999	370.80	27058.81	1853.00	3942.00
2000	392.00	33770.57	4833.00	4262.00
2001	574.00	40658.56	4687.00	5065.00
2002	713.00	47756.11	5287.00	6046.00
2003	1,349.00	55733.78	6451.00	7553.00
2004	1,511.00	68721.39	8735.00	10205.00

Year	FDI	GDP	Exports	Imports
2005	2,305.00	85707.13	10602.00	16983.00
2006	3,549.00	98291.90	11575.00	19112.00
2007	2,436.00	119837.20	17893.00	19254.00
2008	2,601.00	135511.70	24612.00	25930.00
2009	3,414.00	135659.00	17135.00	19064.00
2010	6,102.00	162203.90	23665.40	19760.10

Source: Central Bank of Sudan

Findings for the impact of FDI on the GDP are reported in Table 7.4.

**Table 7.4: Regression Results for GDP**

Variables	Coefficients	SE	T	P-value	R <sup>2</sup>	F	P-value	DW
Constant	21863.97	870.32	3.340	0.005	85.8%	91.76	0.000	1.27
FDI	27.86	3.09	9.579	0.000				

Equation:

$$\text{GDP} = 21863.97 + 27.86 * \text{FDI}$$

It is noticed from the results that the growth of GDP is significantly related to the inflows of FDI to Sudan. Thus, Ho1 is rejected. Note also that the R<sup>2</sup> is 85.8, indicating that a large part of the change in GDP is explained by FDI.

Findings for the impact of FDI on the Exports are reported in Table 7.5.

**Table 7.5: Regression Results for Exports**

Variables	Coefficients	SE	T	P-value	R <sup>2</sup>	F	P-value	DW
Constant	1986.832	1432.73	1.387	0.187	76.5%	45.51	0.000	1.42
FDI	4.197	0.622	6.746	0.000				

$$\text{Exports} = 1986.832 + 4.197 * \text{FDI}$$

FDI has positive and significant relationship with exports as shown by the regression results. Thus, Ho2 is rejected. A high R' also indicates FDI explains a large part of variations on exports.

Findings for the impact of FDI on the Imports are reported in Table 7.6.

**Table 7.6: Regression Results for Imports**

Variables	Coefficients	SE	T	P-value	R <sup>2</sup>	F	P-value	DW
Constant	6732.30	1586.557	2.371	0.033	71.6%	35.370	0.000	1.031
FDI	4.097	0.689	5.947	0.000				

$$\text{Imports} = 6732.30 + 4.097 * \text{FDI}$$

The regression results show an increase in the volume of the imports due to the increase of the FDI. Thus, Ho3 is rejected.

Thus, FDI affects a wide range of economic variable such as GDP, exports and imports.

FDI inflows to Sudan during the reviewed period were long-term in nature and sufficient to promote economic development. It is obvious that FDI received by Sudan has had a positive impact on economic growth. FDI is concentrated mainly in the field of the oil industry, and its contribution to GDP increased. FDI was positively and highly correlated with growth rate of GDP. The hypothesis stated that FDI inflows to Sudan are a factor of growth is accepted.

### **7.5.2 Comparison between the Macroeconomic Indicators of 1991-1995 with Year 2000-2004**

To assess the Sudanese economy performance after the inflow of the FDI as the result of government economic reforms, the researcher compares the macroeconomic indicators of 1991-1995 with year 2000-2004.

As far back as 1990, Sudan initiated the first wave of economic reforms to try and address economic deterioration. The measures agreed to were not fully implemented and a second wave of measures was initiated under the umbrella of the salvation programme, which was merged with the national Comprehensive Plan of 1992-2002. This programme was also not successful and there was deterioration in the balance of payments, escalating inflation rates and persistent macroeconomic imbalances. Another reform programme was introduced 1997-2001 with a sharpened focus on

macroeconomic, price stabilisation and a package of policies to attract FDI (WB, 2005).

The programme encompassed four basic elements including: (1) introduction of stabilisation measures and a macroeconomic environment that focuses on fighting escalating inflation by way of increasing collection of revenues, reduction of public expenditure and following a balanced monetary policy; (2) pursuance of market friendly measures and policies to abolish controls and provide incentives for domestic production and export; (3) introduction of structural reforms to limit role of government by privatising enterprises and rendering opportunities for the private sector in such areas as health, education and other utilities, and (4) encouragement of savings by stabilising the economy and introduction of reforms in the banking sector.

Table 7.7 below compares the macroeconomic indicators of 1991-1995 with the years 2000-2004, highlighting the results of some of the most recent reforms. As we can observe, these macroeconomic indicators started off with low levels of growth rates during 1991-1995, but after 1996 showed signs of improvement. In addition, inflation rates, which peaked during years 1991-95, tapered off during later years and were accompanied by continued decline in government expenditures and inflow of FDI compared to GDP (WB, 2005).

**Table 7.7: Growth Rates of GDP and Per Capita GDP of Sudan 1991-2004**

	<b>1991-1995</b>	<b>1996-2000</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Growth rate of real GDP	3.5	5.7	5.1	8.0	6.5	8.3	7.2
Growth rate of per capita GDP	1.6	3.6	2.8	5.6	4.2	2.2	1.5
Inflation	106.4	43.6	8.0	4.9	8.3	7.4	8.7

*Source:* World Bank 2005 and Central Bank of Sudan 2000-2005

This dramatic change in the performance of Sudan economy since 1996 could be attributed to a number of factors that include: (1) economic reforms and (2) high investment in oil sectors and related services. In addition, stabilisation measures have been facilitated by oil exports which have gained prominence during the past few years. Oil exports increased from zero in 1998 to reach US\$ 276 million in 1999,

accounting for 35% of overall export earnings. In 2004, oil exports reached US\$ 3.097 billion and, in 2009, oil exports accounted for 81% of exports (WB, 2010). With the inflow of foreign direct investments and oil revenues, the economy of the Sudan witnessed a boom in real estate development in major towns, coupled with road construction, development in telecommunications, electrical power supply and investment in food processing industries. However, despite this development, most rural areas and national agricultural development have not directly benefited, resulting in accentuating poverty and continued rural migration.

### **7.5.3 Impact on Trade and Balance of Payments**

The main issue which represents the pivot of the concerns of Sudan in this respect is linked with the impacts on the balance of payments, resulting from opening the door to foreign investments, in as much as this is linked with the expected and actual impacts on trade, returns or the real income of the developing countries. The study and evaluation of the foreign investments impact on trade and balance of payments necessitates the calculation of the inward and outward flows.

The inward flows include the following:

1. The amount of the inward flow from foreign currency or the amount of the foreign investor contribution to the investment scheme. Whenever the contribution of the foreign investor in the scheme increases, the size of the scheme increases, and hence the volume of the foreign currency increases, pursuant to that.
2. The size of the foreign currency availability resulting from imports abundance of goods and different services.
3. The amount of the inward flow of the foreign currency as a result of the export.
4. The amount of the inward flow of the foreign currency in a form of aid from the mother government.
5. The amount of the inward foreign currency resulting from the award of entrance visas and residence for the foreign workers (the sovereignty revenues).
6. The loans that the foreign companies receive from abroad.

The outward flows include:

1. The amount of the outward flows of foreign currency for import of raw and primary materials or the production requirements.
2. The amount of wages, salaries and incentives pertaining to the foreign workers and transferred abroad.
3. The amount of the profits transferred abroad after the start of the production and marketing stage.
4. Amount of the capital transferred abroad after a period from the operation stage.
5. The prices differences of the transfer of primary and raw materials (Abu Gihaf, 2001).

Factors and changes that may affect the balance of payments and trade:

1. The contribution of Multinational Companies to supporting and establishing centres and activities of research, human and technical development.
2. The form of the licensed investment as for the capital, and the scheme type, whether it is characterised by intensive capital or intensive labour force.
3. Number of the national workers in the national centres in comparison with their counterparts of foreigners.
4. The profits amount which is reinvested annually (the cost of the alternative opportunity).
5. Taxes and duties linked with the exports and imports.
6. The currency differences, inflation rate and the interest rates.

#### **7.5.4 Contribution of FDI to the National Income**

The value for gross fixed capital formation (current US\$) in Sudan over the past 35 years has fluctuated between US\$ 13,066,030,000 in 2010 and US\$ 766,087,300 in 1995 (WB, 2011). According to the 1993 SNA, net acquisitions of valuables are also considered capital formation. The highest value of gross fixed capital formation (% of GDP) in Sudan over the past 35 years was 24.57 in 2006. We notice from Table 7.8 that the highest contribution of foreign investment to the National Income was in 2006, where it reached 65.3%.

**Table 7.8: FDI to Sudan in US\$ Million and as a Percentage of Gross Fixed Capital Formation, 2000-2010**

<b>Year</b>	<b>Inflow to Sudan</b>	<b>As % of gross fixed capital formation</b>
2000	392	23.8
2001	574	27.7
2002	713	11.1
2003	1,349	41.8
2004	1,511	35.8
2005	2,305	39.6
2006	3,541	65.3
2007	2,436	23.1
2008	2,601	19.8
2009	3,414	32.8
2010	6,102	58.6

*Source:* Ministry of Investment – Statistical Department – National Income Data.

## **7.6 QUESTIONNAIRE ANALYSIS**

### **7.6.1 Evidence from Questionnaire Survey**

The preceding section provided a questionnaire analysis of the trends and sources of the FDI inflows during 1990–2010 to Sudan and also to discover the obstacles that foreign investors may have to face while doing business in Sudan. The analysis depends upon the information collected with great effort from 200 foreign firms doing business in Sudan, through answering questionnaires and also more information collected through direct interview with 73 key personnel working for foreign firms or the Ministry of Investment, the Oil Corporation, the Ministry of Foreign Trade and the Central Bank of Sudan. The questionnaire and the interviews cover about two-thirds of those corporations which started investment activity in Sudan after 1990. This situation enabled researcher to design a questionnaire for investors to learn their



opinions and ideas regarding investment utility in Sudan under the conditions and environment we have already indicated in previous chapters.

In conducting this survey, primary data has been collected from a questionnaire survey which is analysed in this chapter, sheds light on the issues raised and gives information about FDI in Sudan. The questionnaire used for the survey is shown in Appendix 1. The questionnaire was conducted with foreign investors, who play an important role in investment in Sudan. This study, therefore, surveyed a number of foreign investors. The questionnaire was conducted between November 2009 and January 2010. The findings from the analysis of the primary data thus might support and substantiate the conclusion.

As regards to the process of collecting the primary data, the contact details of foreign investors, with email addresses as well as telephone numbers, were collected from Ministry of Investment. The questionnaire was sent to 375 foreign investors. However, it should be noted that the questionnaires were predominantly conducted by email and telephone. Some of the respondents were requested to be interviewed in person, and we managed a personal meeting with them.

As some of the questionnaires were passed on personally, this provided a personal touch and offered more information. In doing so, this helped to increase the response rate in comparison to that which might have obtained had the questionnaire been sent out only through email or by telephone. In the end, the study only obtained 200 valid responses.

In analysing the questionnaire surveys, we have identified two major questions to be asked. Firstly, finding out about the performance of the FDI in Sudan and, in this respect, information was collected from 200 respondents and covered the following areas:

1. Entry period of FDI.
2. Trends and distribution of the inflows according to economic activity.
3. Geographical distribution of FDI in different regions of the Sudan.
4. Distribution according the sources of the investment.

## 5. Distribution according to the volume of invested capital.

Secondly, to discover the obstacles that foreign investors may have to face while doing business in Sudan, we collected information from respondents identifying the investment obstacles, both quantitatively and by technical classification, and also the non-quantitative obstacles (traditional classical). These two major questions have been derived from one of the main objectives of this thesis which to analyse the effort of the Sudanese government to take measures to attract FDI.

### 7.6.2 Performance of Foreign Investment in Sudan

The economic liberalisation and reform policies led to create a complete economic environment characterised by stability and growth that contributed, in turn, to enhancing the investment environment in the Sudan. Table 7.9 explains the volume and number of National Investments approved in Sudan.

**Table 7.9: Volume and Number of National Investments**

Item/Year	2005	2006	2007	2008	2009	2010
Industrial	923	680	592	471	422	339
Volume \$ (Million)	2.817	3.123	4.757	8.265	3.848	3.298
Service	1248	742	366	325	252	226
Volume \$ (Million)	6.041	7.079	6.429	11.212	2.942	3.683
Agriculture	24	34	23	30	18	17
Volume \$ (Million)	170	144	108	252	97	64
Total	2195	1456	985	826	692	582
Volume \$ (Million)	9.027	10.346	11.293	19.728	6.887	7.045

*Source:* Data collected by researcher

Table 7.9 explains the following:

1. The concentration of approved National Investments in the service sector are because it possessed an average high rate that exceeds 40%, followed by industrial sector and this proves the high profit rate in these sectors, as well as the simplicity of their procedures and general risk reduction.
2. The agricultural sector is considered among the sectors of no great importance in attracting foreign investment because it represents less than 5% of the total National Projects approved during 2005–2010, and this is justified by the high

investment risk in this sector compared to other sectors (industrial and service). In spite of the fact that the agricultural sector occupies relatively great importance compared with both service and industrial sectors, it possessed an average rate of 45% of GDP during the same period.

3. The average volume of the implemented industrial projects reached (with reservation) about US\$ 8 million with an extent that varies between US\$ 3.5 to 18 million dollar per project which are considered as micro projects in contrast to basic industrial macro-projects that require millions of dollars. When this is compared to service projects it is noticed that their highest average rate is within the limit of US\$ 16 million.

Regarding the number and volume of foreign investments and joint foreign projects it is obvious that investors usually enter in the area of their specialisation, seeking maximum profits and avoiding risk. Table 7.10 shows the sectors in which FDI entered during the period 1990– 2010.

**Table 7.10: The Number and Volume of Foreign and Joint Foreign Investments**

Item /year	2005	2006	2007	2008	2009	2010
Industrial	133	183	139	83	98	66
Volume US\$ (Million)	908	1.1669	3.037	1.025	846	238
Service	193	147	113	75	58	53
Volume US\$ (Million)	2.078	1.115	1.603	3.951	1.917	2.389
Agricultural	8	18	8	9	14	7
Volume US\$ (Million)	16	200	381	176	653	8
Total	334	348	260	167	170	126
Volume US\$ (Million)	3.001	2.984	5.020	5.151	3.415	2.634

*Source:* Data collected by researcher

Table 7.10 clarifies the following:

- 1.Foreign and joint foreign investments approved are concentrated in service sector because it occupies an average of high rate that exceed 40% followed by industrial sector for the period 2005 – 2007 and this illustrates the importance of these sector. And this is a clear proof of the existence of highly

profit rates in these sectors due to the easiness of their procedures and general risk reduction.

2. Agricultural sector does not represent great importance in attracting foreign investment because the average of approved national projects in this sector is less than 7% compared with the total number of projects approved during the period of 2005 – 2010, and this proves the great scale of investment risk in this sector in contrast with other sectors ( industrial & service) despite the fact that agricultural sector possessed a relatively high importance compared with both service and industrial sectors in the same period.

Concerning the distribution of foreign investment in different federal states we notice that published data in this regard are very limited beside the availability of some outdated data not gathered since 1999, but they give an indicator of the pattern of geographical investment distribution in the Sudan, reflected in Table 7.11.

**Table 7.11: FDI Geographical Distribution 1990–2010 by %**

<b>Year /state</b>	<b>Khartoum</b>	<b>Gezira</b>	<b>Red Sea</b>	<b>Other states</b>	<b>Total</b>
1990-1994	87.28%	0.00%	12.72%	0.00%	100%
1995-1999	34.52%	65.48%	0.00%	0.00%	100%
2000-2004	67.40%	20.78%	0.21%	11.61%	100%
2005	11.99%	0.28%	87.73%	0.00%	100%
2006	33.37%	0.68%	65.18%	0.77%	100%
2007	50.76%	23.57%	23.74%	1.93%	100%
2008	59.06%	0.00%	39.78%	1.16%	100%
2009	18.96%	38.60%	37.35%	5.09%	100%
2010	60.88%	32.57%	0.00%	6.56%	100%
<b>Average</b>	47.13%	20.22% of	29.64%	3.01%	100%

*Source:* Data collected by researcher

Table 7.11 indicates the following:

1. It appears that most FDI is concentrated in Khartoum State, since Khartoum is relatively the largest and most advanced city in Sudan. It has adequate infrastructure, financial institutions, administration, communications networks, and a high population density. The average investment volume during 1991 to 2010 is 47.13%. Although oil companies operate outside Khartoum, all the oil

companies' offices and residential homes are concentrated in Khartoum. Employees and engineers shuttle between Khartoum and the oil fields.

2. The Red Sea state came in second place after Khartoum with 29.64% of the total investment volume due to availability of good investment basics compared with other states.
3. Gezira State secured 20.22% of the total investment volume during the same period and this reveals the existence of a relatively better investment environment in contrast with the other states in the Sudan with the exception of Khartoum and Red Sea states.
4. It is obvious that middle Sudan states (Khartoum & Gezira) secured the biggest share with a percentage of 67.35% from the total investment during the same period and this confirmed an important historical reality that most development projects are concentrated mainly in the middle of Sudan.
5. Other states in Sudan got only 3% of total investment and this is very weak compared to their density of population and surface areas in contrast with highly investment attractive state. This reality reflects the extent of poverty prevailing in those states compared with the above mentioned ones in regard to availability of investment basics. This illustrates the poor welfare of these states compared with middle Sudan states and the Red Sea. Recently, Northern States could be added to the list of highly attractive investment states due to the great development transformation witnessed by them in the field of enhancing the investment environment and climate.

**Table 7.12: The Structure of FDI firms in Sudan 1990-2010**

<b>Year of Licensing</b>	<b>Number of firm</b>	<b>Number of employees</b>	<b>Foreign private</b>	<b>Private joint</b>
1990-1994	7	80	4	3
1995-1999	21	569	20	1
2000-2004	19	34	17	2
2005	10	876	6	4
2006	10	460	9	1
2007	12	755	8	4
2008	17	934	15	2
2009	22	1592	20	2
2010	37	1528	29	8
<b>Total</b>	<b>155</b>	<b>6828</b>	<b>128</b>	<b>27</b>

*Source:* Data collected by researcher

Table 7.12 shows information on the structure of FDI firms in Sudan. Although the table does not provide an exhaustive listing of all foreign firms in Sudan, it seems that, over time, a growing number of such firms are attracted to Sudan, following the oil boom. The wholly foreign firm is the preferred mode of entry compared to a joint venture with the Sudanese private sector, 128 versus 27 firms. All of the documented firms are classified in terms of employment size. About 6,800 jobs appear to be created by these firms, but the distribution of the employment by nationality is not available.

### **7.6.3 Investment Obstacles: Quantitative Identification and Technical Classification**

The questionnaire was designed according to some indicators prepared by International Finance Corporation of the World Bank. The purpose of highlighting these indicators and adopting them in a questionnaire is to examine the investment environment and its obstacles in Sudan. These indicators enable us to identify the ease and challenges of starting new projects within the investment environment, through quantitative indicators that include all organisational aspects for starting a business in the country.

These indicators include ten phases which represent investment activity life cycle: (1) Starting a business; (2) Dealing with construction permits; (3) Employing workers; (4) Registering property; (5) Getting credit; (6) Protecting investors; (7) Paying taxes; (8) Trading across borders; (9) Enforcing contracts, and (10) Closing a business.

These ten phases cover all aspects of starting the investment activity process and imply good performance quality which is an important indicator in attracting investment, but there are still other aspects related to the business environment added to the questionnaire such as: (1) Closeness to significant markets; (2) The infrastructure of the service sector; (3) Protection of investment property against robbery and theft; (4) Transparency of public purchases, and (5) Total economic and institutional environment power. According to the previous division of investment process into ten phases, the researcher can summarise the information from the questionnaire and interviews, and can demonstrate the actual performance of each phases in Sudan as it is illustrated in Table 7.13.

**Table 7.13: Investment Process in Phases**

<b>Phase</b>	<b>Phase Technical Description</b>	<b>Actual Application</b>
Starting a business	Number of procedures	Ten procedures
	Required time in days	36 days
Dealing with construction permits	Number of procedures	19
	Required time in days	271days
Employing workers	Employment difficulties	39%
	Skilled labour availability	63%
	Employment from abroad	37%
Registering property	Number of procedures	6
	Required time in days	9
	Cost as percentage from property value	3%
Profit transfer	Satisfy regulations	73%
	System running smoothly	41%
Protecting investors	Protection in Investment Law	0
	Conflict with Sudanese shareholders	4
Paying taxes	Number of payments of tax/year	42
	Business profit tax %	13.8%
	Work & Contribution Tax %	19.2%
	Other taxes	3.1%
	Total Taxes to the Profit %	36.1%
Trading cross borders	Number of issued documents	6
	Time needed to finish export or import/day	32

*Source:* Data through questionnaire

Table 7.13 illustrates the following remarks:

1. An improvement in reducing the documentation cycle in the field of foreign trade, exports and imports.

2. The imposition of numerous repeated taxes as well as the increment of their rates. This is an indicator of duplication of taxation authorities at federal and state levels, especially the intensification of collection at the latter level.
3. An improvement in the field of registering property is a positive legal and administrative efficiency and should be generalised at all levels to reduce time duration taken in enforcing contracts and not to confine it merely at registering level.
4. The mentioned obstacles affect the general investment environment in the Sudan and justify the carrying out of studies that lead to identification of the degree of national performance in these different phases of the project life cycle, in order to prepare a Sudanese register parallel to the international register used by International Financial Corporations.

#### **7.6.4 Non-Quantitative Obstacles (Traditional Classical)**

Non-quantitative obstacles mean those obstacles which have no statistical support but for which there is general unanimity between foreign investors in considering them as obstacles. Information collected through the questionnaire could be summarised as follows:

1. Sudan is not classified with a credit rating by international classification corporations and this prevent several investors, particularly the richer ones, from investing in the Sudan because their investment policies are normally limited to countries with a good rating (starting from BBB).
2. Weakness of infrastructure, which could represent a good investment opportunity to some foreign investors at the same time (construction and operation systems plus property transfer BOT).
3. Competence inconsistency between some central ministries and state authorities causes, in most cases, that state authorities do not respond to or recognise the advantages delegated to them by central government in implementing some projects.
4. High rate of collections, fees, production costs and other obstacles imposed by state governments.
5. Allocation of land for investment projects in some states is very difficult due to lack of land free of barriers.



6. In most cases labour laws are not in favour of investors.
7. Most industrial areas lack basic and fundamental infrastructure and this renders the industrial investment environment unattractive.
8. Duplication of agriculture investment fees and insistence of paying them in advance even before starting a business.

#### **7.6.5 Administrative and Legal Obstacles**

Of course, if it is easy to obtain an investment licence, this removes some of the risk from the investor's calculation, and they see it as an important incentive for investment. There are many bodies responsible for investment into Sudan, state and federal. The principle of one access point is not put into practice; all measures of licence, registration of the company, obtaining of the necessary plot of land for the scheme's establishment mean dealing with multiple bodies (customs, taxes, lands, the commercial registrar, Bank of Sudan, the technical bodies and others). This all contributes to the complexity and prolongation of the deal, a matter which negatively reflects on the investment, and especially on foreign investment. In addition, there is a lack of clarity in the relationships between the centre and the states with respect to the execution of the investment schemes. There are not sufficient opportunities for training officers from the investment agencies and overseas contact is limited, so hindering the development of experience. Their reliance on the limited state salaries and lack of sufficient transport and communications means limited opportunities for these personnel to assist in investment propagation internally and externally.

There are issues with land – the lack of ready planned investment lands, the reliance on the old industrial areas which do not suit the desired investment requirements, and the lack of an investment map lead to unclear investment policies and priorities.

As for the legal and legislative aspect, the Investment Law is regarded as the framework that organises the relationship between all the investment operation parties, in view of the fact that it is one of the most important determinants of the investment climate. However, there is some conflict between the investment legislation and the rest of the legislative system of the state, especially in the issues connected with the investment lands dispute. There is also the non-commitment of

some state administrative bodies, depending on the laws that govern them by the execution of the resolutions issued by the specialised authority.

Nevertheless, the text of Article (112) from the Country Constitution states the necessity of the resources division and has led to the non-allotment of the necessary lands for the investment schemes which are licensed federally.

#### **7.6.6 Structural Hindrances**

The deficiency in the infrastructure (roads, electricity and water services, etc.) and non-diffusion of services to cover the whole country, is regarded a main obstacle for investment; the limitation of the local market results from the decrease of per capita income and leads to the narrowness of absorptive energy, which affects infrastructure investment. In addition, the money market is still in need of development and activation, because it has an important mediating job between cash liquidity and financing needs. Although a great portion of FDI has entered the transportation sector, the railways are still in need of many improvements so as to contribute to direct investment development and motivation.

Many investors give testimonies on the excellent performance of the telecommunications sector, which was an obstacle during the 1970s and 1980s, but they now see the importance of the development of other infrastructure.

As for the security aspects, this is reflected in the non-establishment of investment schemes in the unsafe areas which enjoy natural resources, or in some areas in which investment concluded, and hence became subject to risks, as in the case of some investments in Upper Nile area and south of the Blue Nile.

#### **7.6.7 Hindrances with Respect to the Behaviour of Executive of the Investment Policies and Others with Regards to the Investors Themselves**

Some investors come from countries where economies follow the free economy approach, and therefore the procedures and the bureaucratic practices cause many constraints and embarrassment. Such investors need special treatment, because they will not bear any type of inconvenience or prolongation of investment measures, especially at the state entry points such as ports and airports. Therefore, there must be

people at these points with acute awareness and understanding of the needs of these investors.

It is a must to put these people in place because the first impression is important for any investor; his treatment greatly affects the transaction, and this treatment must be applied to all foreign investors.

If we look at these hindrances pertaining to the investors themselves, we find that the regional and international conditions which encompassed Sudan led to its securing a great volume of Arabic investments, but no significant share from Western Europe, US or Japan, which are the countries which have the highest level of resources and technological development. Therefore, most of the investments came from countries of low technological level and few resources. When any economy is characterised by any type of instability, the behaviour of local or foreign investors concentrates on pure commercial perspectives.

The domination of the short-term commercial perspective is one of the most important problems. Some investors lack the forbearance which long-term direct investments require, and this may explain the weakness of foreign investments in the agricultural sector. Also, we find that some investors try to make use of the awarded exemptions to sell the equipment and machines that are displayed, and the examples are many. Some investors invest their money in transportation because of the ease of getting rid of these machines or transferring it again to outside the country.

We conclude that we cannot deny the importance of investment in today's world, because it meets a country's financing needs, contributes to the consolidation of the country's resources in hard currency, and supports export capabilities. Therefore, foreign investments should be at the top list of the priorities of the state (Ministry of Finance, 2002).

## **7.7 CONCLUSION**

This chapter has explored the development and importance of FDI in Sudan. The broad objective was to examine the impact of the FDI flows on the macroeconomic state of Sudan in term of its positive and likely negative effects. To address these

impacts, data drawn from secondary and primary sources is used for the purpose. The Linear Regression Model was used to obtain the results under evaluation. Evidence from the questionnaire survey was obtained. The chapter provided analysis for the trends and sources of the FDI inflows during 1990–2010 to Sudan and focused on the obstacles that foreign investors may have to face while doing business in Sudan.

The main result is that, as outlined above, over the last decades the Sudanese government was able to apply liberalisation policies, economic and financial reforms, and introduced a series of investment promotion Acts. These policies remedied real problems in Sudan's economy, as well as assisted in opening the doors of the economy and paved the way to move productive factors into the economy. It also encouraged foreign capital to contribute to the process and enhance the supply side over the demand side. Sudan was operating under the strict belief that, with its unusual natural and human resources, it would not be able to exploit the good in it without the flows of foreign savings in various sectors.

In previous years, the government was satisfied with the then available official flows from regional and international institutions, and also grants and technical assistance that came through bilateral agreements with European countries. Since the US implemented its boycott of Sudan, the country lost considerable financial flows, as well as grants and technical assistance, whether from Europe, or regional or international financial institutions, especially the IMF and the World Bank. Moreover, Sudan was considered a country that hosted terrorism and the drying up of grants and technical assistance greatly affected many projects earmarked for the rural people of Sudan. Within this narrow framework, Sudan had no alternative except to take stern measures to look towards some friendly nations in order to encourage foreign investments.

It can be seen that the economic liberalisation policies, economic restructuring, attention to the infrastructure, privatisation, and the establishment of the capital market and other measures assisted in opening Sudan's doors. All these policies encouraged a number of investors to take Sudan seriously and decide to invest in Sudan.

## **Chapter 8**

# **THE IMPACT OF FOREIGN DIRECT INVESTMENT FROM CHINA ON ECONOMIC DEVELOPMENT IN SUDAN**

### **8.1 INTRODUCTION**

This chapter provides an assessment of Chinese investment in Sudan, compared with investment from other international sources, and discusses the importance, growth, structure, trend and distribution of Chinese investment (notably investment in the oil sector), trade and aid, and development assistance to Sudan over the period 1997-2010. The researcher provides a comprehensive analysis using the most recent secondary data to discuss the positive and negative impacts of FDI from China to Sudan. Tabular analysis is used to review the scale of operations of the investing firms. An understanding of the behaviour and motivations of these firms is gauged in light of the Dunning OLI framework and its various extensions.

As will be discussed, the various positive impacts of Chinese investment in Sudan and the opportunities for enhancing development in Sudan's economy include: the impacts of oil in satisfying domestic consumption and achievement of self-sufficiency; increasing government and public revenues; rapid and impressive economic growth as measured by the growth in GDP and its composition and structure; increasing FDI, and the increase in the volume of foreign trade, as measured by the volume and structure of exports.

However, it is also found that, while oil has recently contributed to the improvement of economic performance in the country, the recent heavy dependence on it may lead to negative impacts and serious challenges for Sudan, since oil is related to potential north-south conflict and division of the country.

The researcher finds that Sudan has directed itself towards the countries of South East Asia instead of Western European countries, the US or Arab countries. Sudan and China's long-term partnership has led to real economic growth for Sudan, averaging

approximately 9% during the period 2005-2006, placing Sudan among the fastest growing economies in Africa (World Bank, 2008).

Many Western European countries, the US and Arab countries, as well as regional and international institutions, ceased to extend any assistance to Sudan whether in the form of loans, grants or technical and humanitarian assistance. The US imposed economic sanctions, listing Sudan as one of the countries in the area that hosted terrorists. Sudan had no alternative except to take measures to encourage foreign investment. It was apparent to Sudanese policy-makers that Sudan was bound to face many difficulties. In anticipation of this, Sudan directed itself towards the countries of South East Asia, such as China, Malaysia and Indonesia.

China's recent push into Sudan is driven by a significant need to find oil and industrial raw materials to feed its resource-hungry economy, which is the fastest growing in the world. In its search for resources and new export markets, China has turned to Africa, which boasts vast natural resources, including oil and gas, metal ores and cotton (Ali, 2006). One-third of the world's resource-dependent economies are African. As it did during the Cold War, China is also seeking to deepen alliances with African countries to enhance its global standing, and to counter Western influence in world bodies such as the United Nations and the World Trade Organization.

This chapter assesses how FDI in Sudan from China compares with that from Europe. This chapter provides a comprehensive analysis using the most recent secondary data to discuss the positive and negative impacts of the Chinese presence in Sudan. The Sudanese perspective is that China can have a positive influence on the country's development if the negative aspects of its business and aid practices are addressed.

Explaining the case of Sudan is both interesting and significant because of the recent, increasingly rapid, growth and structural change in Sudan's economy after the exploitation of oil in the country. Within the last ten years, Sudan has sustained steady growth, driven by global demand for oil and industrial raw materials, and by improvement in domestic supply response. Global high demand for oil and industrial raw materials has encouraged FDI in Sudan, particularly from China, the fastest growing developing country.

According to UNCTAD, global FDI flows as a percentage of gross fixed capital formation to Sudan in the years 2005, 2007, 2008, and 2009 were 30.2%, 21.9%, 21.2% and 27.6%, respectively (UNCTAD, 2009). Sudan's economy has grown by an average of 9% per annum over the last ten years; the fastest growth rate for the Sudanese economy in its recorded history, with China displacing Europe as Sudan's largest trading partner. China accounts for nearly 72% of Sudan's total exports and more than 38% of its imports.

## **8.2 CHINESE INVESTMENT IN DIFFERENT SECTORS IN SUDAN**

China is the major player in the Sudanese oil industry. China uses a combination of investment, trade, aid flows and diplomacy channels to foster long-term partnerships with Sudan, which possesses resources it wants to obtain, especially petroleum.

This section provides an assessment of the importance, growth, structure, trend and distribution of Chinese investment (notably investment in the oil sector), trade and aid and development assistance to Sudan over the period 1997-2010.

### **8.2.1 Chinese Investment in the Oil Sector in Sudan**

To explain the importance of Chinese oil and non-oil investment compared to foreign oil and non-oil investment in Sudan, we can use quantitative secondary data on the share of China's oil and non-oil investment, relative to total foreign oil and non-oil investment in Sudan over the period 1997-2010.

Beginning with China's investment in the non-oil sectors, according to unpublished data from Sudan's Ministry of Investment, apart from oil, the Chinese non-oil investment contributed to foreign investment implemented by all foreign countries in different sectors in Sudan during the period 2000-2007. For instance, the estimated value of Chinese investment in total, petroleum, industrial, services and agricultural are equivalent to US\$ 6,005,774 thousand, US\$ 6,000,000 thousand, US\$ 4040.5 thousand, US\$ 1728.5 thousand and US\$ 5.0 thousand respectively (Ali, 2006). This implies that the share of China in the total FDI by all foreign countries implemented in different sectors in Sudan during the period 2000-2007 is equivalent to 47.63%,

0.56%, 0.08%, 0.02% and 38.67% in petroleum, industrial, services, agricultural and total across sectors, respectively (Ali & Elbadawi, 2002).

This also implies that the largest share of Chinese investment is concentrated in the petroleum and oil sector. The distribution of total Chinese investment in different sectors in Sudan during the period 2000-2007 reveals a biased distribution, since the share of petroleum, industrial, services and agricultural sectors in total Chinese investment in all sectors is 99.90%, 0.07%, 0.03% and 0.0001%, respectively. This therefore implies that it is particularly useful to focus the analysis on Chinese investment in the oil sector.

To explain the importance of Chinese investment in the oil sector in Sudan, compared to foreign oil investment from other countries in Sudan, use is made of quantitative secondary data on the share of Chinese oil investment relative to (as a percentage of) total foreign oil investment from other countries in Sudan over the period 1997-2008. Significant Chinese investment in the oil sector in Sudan over the period 1999-2008 is evidenced from the share of China in oil concessions, investment in upstream and downstream oil, investment in oil pipelines, investment in oil refineries and investment in marketing, industry and manufacturing within the oil sector in Sudan.

Beginning with concessions in the oil sector in Sudan, among Asian countries, China's share is significant over the period 1999-2008. A recent report by the Ministry of Energy and Mining (2008) shows sizeable Chinese investment and concessions in the oil sector which includes many Chinese companies and extends to many blocks. For example, we observe the significant share of China (China National Petroleum Company or CNPC, 40%), compared to Malaysia (Petronas, 30%), India (ONGS, 25%), and Sudan (Sudapet, 5%) in total concessions in the Greater Nile Petroleum Operating Company (GNPOC) in blocks 1, 2 and 4. In addition, China holds a significant share of total concessions in Petrodar Petroleum Operating Company (PDOC) in blocks 3 and 7, with CNPC holding 41% and SINOPEC holding 6%, compared to Malaysia (Petronas, 40%), UAE (Thani, 5%) and Sudan (Sudapet, 8%) (Sahu, 2009). The China National Petroleum Company International Sudan in block 6 is a further example, with China holding 95% (CNPC) of the total concession, compared to the 5% share of Sudan (Sudapet). China's Petroenergy holds 40% of



total concessions in group of companies in block 13, compared to Indonesia (Petramina) with 15%, Sudan at 15% for Sudapet and 10% for Dindir, Nigeria with 10% (Express), Nigeria with 10% (Africa Energy). China (Petroenergy) also holds 35% of the total concession in Red Sea Oil Company in block 15, compared to Malaysia (Petronas, 35%), Sudan (Sudapet, 15%), Nigeria (Express, 10%) and Sudan (Hi Tech, 5%).

According to the Sudanese Ministry of Energy and Mining (2008), Chinese investment in the oil sector is diversified to include both the upstream and downstream sector. China's grand total investment in the oil sector in Sudan over the period 1999-2008 is equivalent to US\$ 6,003.15 million, including total investment in upstream equivalent to US\$ 40,723 million, and total investment in downstream equivalent to US\$ 1,930.85 million. This means that China represents 47.3% of Asian countries' total investment in the Sudanese oil sector, and 43.8% and 56.9% of Asian upstream and downstream investments, respectively (Ali & Elbadawi, 2002). The Chinese share represents 47.3%, compared to the share of Asia as a whole in total foreign investment in oil, which is 84.4%. The Asian countries investing in the Sudanese oil sector include China, Malaysia, India, Pakistan, Kuwait and Iran. In particular, the Chinese companies CNPC and SINOPEC invested US\$ 40,723 million, which accounted for 43.8% of total Asian countries' investment in the upstream oil sector in Sudan over the period 1999-2008, which accounted for 84.4% of the share of total Asian investment in total foreign investment in the upstream oil sector in Sudan over the period 1999-2008.

In particular, the significance of China's investment in the upstream oil sector in Sudan over the period 1999-2008 is obvious: the contribution of China (SINOPEC) of investment equivalent to US\$ 129.4 million in PDOC in blocks 3 and 7; investment (CNPC) equivalent to US\$ 2,146.8 million in GNPOC in blocks 1, 2 and 4; investment equivalent to US\$ 884.5 million in PDOC in blocks 3 and 7; investment equivalent to US\$ 906.0 million in Petroenergy in block 6; and investment equivalent to US\$ 5.6 million in Red Sea Petroleum Operating Company (RSPOC) in block 15. This indicates that the total Chinese investment in the upstream oil sector in Sudan is equivalent to US\$ 3,942.9 million, out of a total Asian investment in the sector equivalent to US\$ 9,292.4 million. In addition, the importance of Chinese investment

also appears when examining expenditure. A recent report by the Ministry of Energy and Mining (2008) shows the share of Chinese companies in the total expenditure of oil-operating companies in Sudan over the period 1993-2007 as follows: GNPOC, 53.46%; PDOC, 21.50%; PETROENERGY, 9.50%; White Nile Petroleum Operating Company (WNPOC), 12.01%; WNPOC, 0.84%; WNPOC, 0.62%; SUDPAK, 0.47%; SUDPAK, 0.18%; SUDPAK, 0.07%; TOTAL, 0.26%; Advanced Petroleum Operating Company (APCO), 0.94%; and RSPOC, 0.16%.

In addition, in terms of investment in pipelines, Chinese investment from 1999 to 2008 was equivalent to US\$ 1,333.8 million compared to Sudanese and other Asian investment equivalent to US\$ 2,950.2 million. Chinese investment implemented by CNPC through investment in the Hejlij-Bashaire pipeline was equivalent to US\$ 488 million, with further investment in the Alfoula-Algeli pipeline equivalent to US\$ 366 million, and in the Floug-Bashaire pipeline equivalent to US\$ 479.8 million. Meanwhile, investment by Chinese firm SINOPEC alone in the Floug-Bashaire pipeline was equivalent to US\$ 70.2 million. A Chinese share equivalent to 47.6% of total Asian investment in pipelines was thus made, with CNPC's investment equivalent to 45.2% and SINOPEC's equivalent to 2.4% of total Sudanese and other Asian countries' investment (Alden, 2007).

Furthermore, Chinese investment in Sudanese oil refineries is significant over the period 1999-2008. China (CNPCC) and Sudan (Sudanese government) formed a partnership for the establishment of the Khartoum refinery, with a total establishment cost equivalent to US\$ 640 million; each partner contributed 50% of this figure, or US\$ 320 million each. In addition, China (CNPCC) and Sudan (Sudanese government) extended their partnership for the Khartoum refinery's expansion, at a total cost equivalent to US\$ 350 million, of which each partner contributed US\$ 175 million. Moreover, in petrochemical factories, the investment and contribution of China (CNPCC) is equivalent to US\$ 21.85 million, representing 95% of a total investment equivalent to US\$ 23 million compared to Sudan (Sudanese government), whose contribution was equivalent to US\$ 1.15 million and constituted 5% of the total investment. Altogether, this means that, of a total investment equivalent to US\$ 1013 million in the Khartoum refinery, its expansion and in the petrochemicals factory, the contribution and share of China (CNPCC) was equivalent to US\$ 516.85 million and

51%, while the contribution and share of Sudan (Sudanese government) was equivalent to US\$ 496.15 million and 49%.

In addition, significant investment was made by China and other Asian countries in marketing, industry and manufacturing within the oil sector in Sudan over the period 1999-2008. Of the total Asian investment, equivalent to US\$ 80.2 million, the investment by China through Kandoc Petrochemical was 12.5% of the total, equivalent to US\$ 10 million, compared to Malaysian (Petronas, 48.3%) investment equivalent to US\$ 38.7 million, Iranian (Benasag Iran Gas, 18.7%) investment equivalent to US\$ 15 million, Indian (Gapco, 14%) investment equivalent to US\$ 12 million, and UAE (SudaGas, 5.6%) investment equivalent to US\$ 4.5 million

### **8.2.2 China and Sudan: Trade Relationships**

The significant Chinese investment in the oil sector in Sudan has motivated trade relations between the two nations, and hence widespread trade with China is occurring, as China buys oil from Sudan and, in turn, Sudan has bought many items from China, fuelling both economies.

To explain the importance of the Chinese trade with Sudan compared to that of other foreign countries, quantitative secondary data is used concerning the share of Chinese trade (exports and imports) with Sudan, relative to (as a percentage of) total foreign trade (exports and imports) of other countries with Sudan over the period 1997 to 2010. The data shows that, over the period 1999 to 2010, the total volume of exports and imports (measured by commodities) between Sudan and China was equivalent to US\$ 39.241 and US\$ 11.576 million respectively (Bank of Sudan Annual Report, 2010). Over the period 1997 to 1999, the trade balance was in favour of China, whereas after that, over the period from 2000 to 2010, the trade balance turned to emerge in favour of Sudan, and the deficit to China increased from US\$ 615 million in 2000 to US\$ 2,603 million in 2007. The overall balance is in favour of Sudan and is equivalent to US\$ 4.278 million. This is not surprising given the increase in oil exports to China, as will be explained below.

According to data and statistics from the Central Bank of Sudan, during the period 2000 to 2010, the value and share of China in Sudanese foreign trade was significant

compared to other main importers to, and exporters from, Sudan. China's share of Sudan's total exports to all foreign countries showed an upward trend over the period, as shown in Table 8.1 below. Meanwhile, the Chinese share of Sudan's total imports from all foreign countries also rose, demonstrated in Table 8.1. The average share of China in Sudan's total exports and imports over the period 2000-2010 was 69.56% (Suliman, 2011).

**Table 8.1: Chinese Share of Sudan's Total Exports and Imports, 2000-2010**

<b>Year</b>	<b>Chinese share of total exports</b>	<b>Chinese share of total imports</b>
2000	44.1%	6.56%
2001	59%	10.66%
2002	65.74%	8.02%
2003	69.31%	7.95%
2004	66.89%	13.0%
2005	71.04%	14.79%
2006	75.03%	19.14%
2007	81.95%	30.18%
2008	75.02%	32.02%
2009	75.77%	19.88%
2010	81.42%	14.16%

*Source:* Central Bank of Sudan

Sudan's exports to China include limited commodities, and the few commodities which Sudan exported to China rapidly increased during the period 1997 to 2010. As for petroleum and petroleum products, according to data and statistics from the Central Bank of Sudan for the period 2000-2010, the value and share of China in Sudanese exports is significant, compared to other main exporters from Sudan. Over the period 2000-2010, China's share in Sudan's total exports of petroleum and petroleum products was equivalent to 80.07%. The share of petroleum and petroleum

products in Sudan's total exports to China from 1997-2010 is given in Table 8.2 below. Over the period 2000-2010, the share of petroleum and petroleum products in Sudan's total exports to China was equivalent to 99.4% (Suliman, 2011).

**Table 8.2: Chinese Share of Sudan's Total Petroleum Exports, and Petroleum as a Percentage of Sudan's Total Exports to China, 1997-2010**

<b>Year</b>	<b>Chinese share of total petroleum exports</b>	<b>Share of petroleum and petroleum products in Sudan's total exports to China</b>
1997	-	0.00%
1998	-	0.00%
1999	-	0.00%
2000	58.87%	99.76%
2001	72.78%	99.98%
2002	85.03%	99.91%
2003	84.99%	98.77%
2004	80.64%	98.94%
2005	80.86%	98.8%
2006	82.3%	98.86%
2007	86.16%	99.68%
2008	78.85%	99.92%
2009	82.63%	99.29%
2010	87.7%	99.53%

*Source:* Central Bank of Sudan

As for the non-oil exports, over the period 2000-2010, the average share of China in Sudan's exports to all foreign countries in other non-oil commodities include cotton (7.75%), gum Arabic (0.34%), sesame (10.49%), skins and hide (5.37%), and other (2.31%). It is clear that petroleum and petroleum products dominate Sudan's exports to China, at 99.4%, while all other non-oil exports to China represent only 0.6%.

Furthermore, China is the largest importer of Sudan's petroleum and petroleum products, at 80.07%, while Sudan's exports of petroleum and petroleum products to all other countries represents only 19.93%.

As for Sudan's imports from China, the data shows that imports to/for Sudan from China were diversified by rapid increases for many commodities during the period 1997-2010. From 2000-2010, the average share of China in Sudan's total imports from all foreign countries for various commodities include coffee and tea (0.07%), wheat and wheat flour (5.50%), other food stuffs (3.89%), beverages and tobacco (8.29%), petroleum products (0.002%), crude materials (3.16%), chemicals (11.31%), manufactured goods (21.01%), machinery and equipment (20.63%), transport equipment (13.59%), and textiles (35.43%). In addition, over the period 1997-2009, a significant increase is observed in the Chinese share of Sudan's total imports of crude materials, which increased from 0.81% in 1997 to 5.16% in 2009; chemicals (from 3.98% in 1997 to 11.35% in 2009); manufactured goods (from 10.27% in 1997 to 25.72% in 2009); machinery and equipment (from 14.83% in 1997 to 28.84% in 2009); transport equipment (from 7.36% in 1997 to 12.06% in 2009) and textiles (from 7% in 1997 to 47.26% in 2009). As for total imports, the Chinese share in Sudan's total imports from all foreign countries was 6.28%, 13.80%, 4.56%, 6.56%, 10.66%, 8.03%, 7.95%, 13%, 20.47%, 20.8%, 27.76%, 23.13%, 19.88%, 14.16% and 15.67% in 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010 and from 2000-2010, respectively (Suliman, 2011).

### **8.2.3 Chinese Aid and Development Assistance to Sudan**

The significant investment of China in the oil sector in Sudan motivated China to increase its aid and development assistance to the Sudanese economy over the period 1997-2009. China's share in the total loans and grants offered to Sudan show a declining trend over the period 1999-2004, with the proportion of total foreign aid (loans and grants) to Sudan declining from 17% in 1999 to 0%, 0%, 7%, 8% and 7% in 2000, 2001, 2002, 2003 and 2004, respectively (Ali 2006). Thereafter, this share dramatically and rapidly increased to 76% in 2005, declining to 24% in 2006, before increasing once again to 73% in 2007, declining to 3.35% in 2008, and then increasing to 27.44% in 2009. One possible explanation for this changing trend is that

the rapid increases in 2005 and 2007 can probably be attributed to China's consistent policy of increasing the cooperation and involvement of China with Africa's oil-rich countries by increasing aid, investment and trade with those countries, including Sudan.

Another interpretation is that the implementation of the peace agreement in 2005 probably encouraged China to increase her involvement in offering aid and development assistance to Sudan. A further justification is the increase of Chinese involvement in the oil sector in Sudan. On the other hand, the declining trend in 2006 is probably due to the policy of the Chinese government of reducing development assistance and aid to developing African countries, including Sudan, while another interpretation is that this was due to a general decline in the Chinese grant to Sudan from 36% in 2005 to 14% in 2006 (Ali, 2006), the year which witnessed rapid increase in the share of grants in total foreign aid offered by all foreign donors to Sudan, from 0.3% in 2005 to 19% in 2006. The great decline over the period 2007-2009 is probably related to the global economic and financial crisis which led to a drop in the inflow of resources from foreign donors.

These findings indicate China's large and significant share of international aid and development assistance to Sudan compared to that of other countries over the period 1997-2009. It is observed that the Chinese share of aid and development assistance to Sudan rose from 33% to 45% and then 58% during the periods 2002-2007, 2004-2007 and 2005-2007, respectively.

These findings are consistent with the facts which indicate the rising share and significance but irregular nature and considerable fluctuations in Chinese aid and development assistance to Africa, and particularly to Africa's oil-rich countries over the period 1999-2007.

The results indicate the effectiveness and significance of China's contribution to the implementation of several development projects, and imply that the increase in the inflow of Chinese aid and development assistance in the form of loans has caused mixed positive and negative impacts for Sudan's economy over the period 1997-2007. On the one hand, this has had a positive impact by providing alternative sources of finance to complement the shortage of domestic capital for financing development

projects. On the other hand, it has had a negative impact by increasing Sudan's external obligations and debts to China, by increasing Sudan's total external obligations and debts, and by offering tied aid, hence undermining the effectiveness of Chinese aid to Sudan. The findings show that the increasing inflow of Chinese aid led to an increase in the Chinese share of Sudan's total debt from 0.9% in 1999 to 13.45% in 2007. The main reason behind this negative impact of increasing Sudan's debts to China is probably the nature of the composition of Chinese aid (Sahu, 2008): the share of total grants and technical and commodity aid (5%) is less than the share of total loans (95%).

This composition implies that the majority (87%) of Chinese aid offered to Sudan from 1990 to 2008 was in the form of commercial loans, which caused a negative impact by increasing debt, which was offered with petroleum guarantees and with interest rates which caused an increase in the debt problem in Sudan, as in many other developing countries. In addition, the Chinese aid to Sudan is tied to trade, FDI and importance of oil to the Chinese economy. Despite the global financial and economic crisis, China has reaffirmed its intention to fulfil earlier commitments and to maintain further aid and development assistance to Sudan: however, China is expected to continue commitment to a win-win policy and is likely to continue offering tied aid to Sudan to maintain the strategic economic opportunities and interests of its engagement in Sudan and its access to oil.

### **8.3 LONG-TERM RELATIONSHIP BETWEEN SUDAN AND CHINA**

Since the 1980s, China has adopted a 'going global' strategy that encourages Chinese companies to invest abroad to guarantee access to advanced technology, foreign exchange, energy and raw materials, and export markets (Ali & Elbadawi, 2002). The strategy also seeks to encourage Chinese firms to 'cut their teeth' in international markets and enhance China's global power status. In Sudan, Chinese state-owned and private companies have entered into a number of joint ventures with the Sudanese national government, state-owned corporations and private firms.

Over 100 registered Chinese companies are reported to be operating in Sudan. Beijing is encouraging Chinese companies to acquire and develop strategic oil and gas fields in Sudan to mitigate anxiety about secure supplies of energy (Ali, 2006). It is also



encouraging Chinese state-owned companies to source their own raw materials abroad, creating a strategic motivation for investing in Sudan's resources. Flagship enterprises in the energy, construction, engineering and manufacturing sectors receive generous government support in preferential loans and credit through the Chinese Development Bank, the China Construction Bank and Eximbank, as well as in tax deductions (Ali & Elbadawi, 2002).

The China Eximbank supports Chinese companies to expand their presence in Sudan. The largest Chinese operations in Sudan are in oil and gas exploration, development and production, and there is growing investment in construction and engineering works, telecommunications, textile manufacturing and trading enterprises. A significant feature of Chinese investments is that they can be found in countries and in projects considered too risky by Africa's traditional donors and investors. The biggest recipients of Chinese investments in Africa have been the largest oil producers on the continent: Nigeria, Angola, Sudan and Equatorial Guinea.

Chinese development aid helps to finance infrastructure projects, including road and railway rehabilitation, hydropower stations, stadia, hospitals and schools. By 2005, Chinese companies had been contracted to many turnkey projects across Sudan. By mid-2006, China Eximbank's concessional and non-concessional loans for infrastructure development in Africa, excluding projects in the petroleum and mining sectors, totalled US\$ 12.5 billion (World Bank Report, 2007). Angola, Nigeria, Sudan and Zimbabwe account for over 80% of these loans, and the power sector makes up about 40% of total commitments, followed by 'general' or multiple sector commitments (24%), transport (20%), telecoms (12%) and water (4%). According to a Wall Street Journal report (2008), Chinese companies have paved more than 80% of the main roads in Sudan.

China's political relations with Sudan date back to the 1980s, when relations between the two were based on a mutual ideological struggle against powerful international actors and, more importantly, on China's desire to balance US influence in Africa. China continues to play the colonial card in its relations with Africa by emphasising a shared exploitation by imperial powers. To win hearts and minds in Sudan, China is promoting itself as a *de facto* leader of the developing world, a developing country

better able to understand Sudanese challenges.

Major Western governments refuse to deal with the Sudanese regime, which is perceived to be repressive or corrupt and, generally, Western companies have followed this cue (Ali & Elbadawi, 2002). China makes no such discrimination in its partnership with Sudan. Instead, China sees the reduction of Western influence as an opportunity to deepen alliances for both economic and political benefits. China has moved in to fill the void created by the absence of major Western powers in countries such as Sudan. Some of the largest Chinese aid and investment programmes have also gone to these 'pariah' countries with abundant reserves of natural resources. Africa's most embattled regimes, including Sudan, have found their closest external ally in China, regularly receiving senior Chinese officials.

In the 1990s, the US Government broke diplomatic links with Sudan for the Sudanese government's 'terrible' human rights record. Western companies withdrew after the US passed a law to bar US oil companies from investing in Sudan. The China National Petroleum Corporation had already won a bid in Sudan in 1995. Beijing quickly moved in as the next external power broker, and Chinese companies followed, ramping up huge investments in Sudan's oilfields, refineries and pipelines. Previously a net importer of oil, Sudan now earns some US\$ 2 billion in oil exports each year, half of which goes to China.

On a number of occasions during the period from 2004 to 2010, China threatened to use its veto in the UN Security Council to block sanctions and oil embargoes against Sudan for the continuing violence in Darfur. The resulting Resolution (1564) only threatened Sudan with an oil embargo and was agreed only after China's abstention and a textual amendment giving the African Union the mandate to manage the crisis. In April 2005, China again abstained in an attempt by the Security Council to use the International Criminal Court to bring the perpetrators of the Darfur crimes to justice. Perhaps from their own experience of humiliating external interference in China's history, Chinese officials see sovereignty as more important than human rights. However, the reason for China's behaviour is partly economic. Sudan supplies 8% of China's total oil imports, and a recent corporate report by the CNPC has revealed that this Chinese company obtains nearly half of its overseas oil output from Sudan. Any

sanctions on Sudan will have significant adverse impact on Chinese oil supplies.

One of Sudan's biggest challenges is building physical infrastructure to support development and to facilitate the flow of goods and services between its different parts as a huge country (Ali & Elbadawi, 2002). However, the 'international community ... [has focused] on relief and emergency activities' and other 'short-term palliatives aimed at reducing the visible symptoms of low levels of economic productivity' (Ali & Elbadawi, 2002). Not only have Western donors and investors long neglected investment in Sudan's infrastructure; they are also failing Sudan on their own promises to double humanitarian aid. The Chinese government is not only fulfilling its aid promises to Sudan: a Sudanese policy-maker notes that, 'it is also encouraging Chinese companies to invest in infrastructure development in Sudan.'

There is also growing satisfaction that the Chinese presence in Sudan is drawing attention to Sudan's potential. China's brutal competition for assets is raising the value of Sudanese assets, sometimes through competitive overpayment for equity positions, 'which releases more resources for local development' (Ali, 2006). Also, however, such overpayments may end up providing 'extra windfalls for corrupt officials instead of benefiting local communities' (Ali, 2006).

The Chinese government and companies are prepared to invest in Sudan and other high-risk countries. In many such conflict-affected countries, a great proportion of the population is grateful to see new schools, roads, railway lines and stadia springing up from the debris of war. In post-war times and even during war in Sudan, Chinese aid is financing a range of projects to strengthen the machinery of government and the national security apparatus. A new office block, services buildings and a new military headquarters for the government of Sudan have been built with generous support from the Chinese government, while Chinese companies have invested in other projects which are providing jobs for the local population.

According to Ali and Elbadawi (2002), the international community's concerns about the Chinese presence in Sudan range from preserving normative cosmopolitan ideals such as the protection of human rights, political freedoms and the environment, to fears about diminishing Western political and material influence in Africa. As with the local responses, international views are mixed, although there is a preponderance

of negative perceptions about Chinese activities in Sudan.

In the UN Security Council, China has used its veto right to ‘undermine’ sanctions against the Sudanese government, which has refused to cooperate with the African Union and the UN on the deployment of a large peace-keeping force to end the crisis in Darfur that has already killed hundreds of thousands of people. A Time Magazine report accuses China of providing 400 Chinese troops to protect Chinese oil interests in Sudan, while contributing only 1,400 troops to UN peace-keeping missions worldwide. Recent reports suggest that China is probably beginning to heed the message from these numerous criticisms. China could enhance its own global standing by using its influence to support measures to end conflicts in Sudan.

#### **8.4 AN ANALYSIS OF CHINA’S FDI**

This section provides answers to questions about the benefit of Chinese FDI to Sudan; what are the overall benefits of China’s FDI; is China’s FDI complementary or competitive; is China FDI in Sudan bundled with aid; is China’s FDI in character from FDI sourced from other sources and, finally, what are the spillover effects of China’s FDI?

##### **8.4.1 Overall Benefit of China’s FDI**

China’s oil investment has the double effect of expanding the export sector (see Table 8.1) and reducing Sudan’s dependence on imported key oil products. The investment of the CNPC in the domestic refining capacity has contributed to import substituting industries which, in turn, augments domestic value addition and gives rise to other processing industries based on oil namely plastic products and road construction. Windfalls from crude oil production are the major value added, and the share of the government started from scratch to reach about 56% in 2008. All oil revenues are channeled through the public sector, which publishes aggregate data on crude oil production and government share (Sudan Ministry of Finance website).

The contribution of petroleum to economic activities has progressively grown from 1% in 1999 to an estimated 18% by 2010. Real GDP showed strong growth over 1999-2010 with the rate of growth averaging 7.9%. The share of the MNCs represents an outflow in terms of repayment of the invested capital.

The size of direct employment generated by China's FDI in the oil sector is limited due to capital intensity of this investment. The MEM (2009) showed that about 3,000 jobs for nationals were created in the oil sector. However, as noted earlier, the private sector Chinese FDI seems to generate many more jobs.

#### **8.4.2 China's FDI Complementarities and Competitiveness**

All oil companies in the producing fields work jointly with Sudapet, which is an affiliate of Sudan's National Petroleum Company. The Company holds all licenses and its shares ranges from 5% to 30%.

Five large Sudan-based companies were involved in provision of transport, feeder roads construction, civil work and seismic survey services. Some of these firms, notably Hijilig Oil Service and Danfodio Ho, subcontracted numerous local providers. These two firms also worked jointly with other China-based companies in providing services for the construction of Merowe Dam. Danfodio Holdings, which is the largest commercial and construction company in Sudan with 12 subsidiaries, has implemented 35 contracts with Chinese firms. The company even internationalises in a joint venture with China's Transtech Engineering to build a US\$ 634 million railways project in Mauritania.

About 31 of the licensed private Chinese firms enter into joint venture with Sudanese counterparts and hence contributed to strengthening them. Some of the incoming firms operate in processing imported inputs and components for industry which drums up business. Their activities include advertisement designs, business logo and paper design, as well as ICT components assembly. A niche urban market is created for numerous local firms. Some of the local firms had already started similar activities, benefiting from the markets for cheap raw materials opened up by the Chinese private firms. As a broad generalisation, it could be said that China's FDI is more complementary with domestic firms than competing.

#### **8.4.3 China's FDI and Aid**

Is China's FDI in Sudan bundled with aid? Previous sections suggests that the answer is yes. Sudan borrowed more from China after its conventional sources of credit dried up due to the huge arrears and loss of seal of approval for new loans. In addition, the Western sanctions limit the country's access to loans and aids from non-official

sources. By default, China increasingly provides loans and aid-in-project to Sudan. For example, project-based lending increased more than 18 times from US\$ 0.01 billion over 1970-2000 to US\$ 1.84 billion over 2000-2007. With the exception of ginning which received less than 0.01% of the total, the rest of the loans were committed in infrastructure projects, mainly electricity, water and dams. The repayment schedule and the interest charged on these loans are not available. However, the charges in general vary from 0 to 3% and the repayment period from three to 30 years (MFNE, 2008).

#### **8.4.4 Importance of China's FDI**

Does Chinese FDI differ in character from FDI sourced from other sources? In the wake of the liberalisation since 1989 there are many reasons advanced for promoting multilateral dealing and delinking of aid, trade and FDI vectors, which were inevitably combined during the colonial era for the sake of developing the export sector of the colonies (Kaplinsky & Morris, 2009). Notwithstanding, China's FDI in Sudan represents an integrated vector of aid, trade and FDI. One reason is situational, in the lens of the OLI-IDP, Sudan exemplifies a typical accumulation model, dominated by natural resource extraction and import substituting industries with limited intra-industry investment and trade. These are not Sudan-specific characteristics. As explained by Dunning (2000), the majority of the countries in stage 1 and 2 of their IDP exhibit such traits and are disadvantaged by globalisation, which weakens their L and are not able to sufficiently supply the kinds of facilities the MNCs need to complement their own O advantages. Moreover, the opportunities for sequential FDI remain limited, especially in higher value added activities, which provide the most significant potentials for spillovers. With limited assets and L advantages to offer MNCs, resource seeking is often the only FDI to occur. In such case an integrated vector of aid, trade and FDI is bound to arise at least to coordinate a 'big push' in the export sector. Another reason is that Sudan has been under sanctions for a long time, which makes it difficult for the country to source the needed investment multilaterally.

Increasingly, the large Indian firms investing in SSA's resources and infrastructure sectors follow a strategy similar to Chinese MNCs, and it is not a bad strategy at all. The SSA countries can adopt an analogous strategy of integrating the aid, trade and

FDI vectors to leverage investors to meet their complementary developmental and infrastructural needs (Kaplinsky & Morris, 2009).

Sudan could follow such wisdom to attract more Chinese FDI into its declining agricultural sector. It was noted earlier that this sector attracted only six small private firms. Food processing, and enhancing value addition in the traditional export sector are other potential candidates. As pointed by Kaplinsky and Morris, agreements on bundling can be reached informally through government-to-government discussions without running up against WTO rules.

A major problem Sudan faces relates to the misinterpretation of the classic symptoms of the resource curse associated with the export enclaves by activists and NGOs to propagate for invest or divest. Such enclaves are typically isolated from the rest of the economy, often politicised and remain a source of violence over distribution of resource rent in many LDCs.

Collier (2007) pointed to the violence over distribution and the Dutch disease of natural resource abundance as critical internal reasons for the failure of the countries of the bottom billion. The other two reasons relate to lack of accessibility to global markets resulting from being landlocked with bad neighbours and bad governance. Generally, Bichler and Nitzan (1995) point to an external reason for the propagation of conflicts, relating to the possibility of linking the conflict to the weapon dollar-petrodollar coalition of large defense contractors and MNCs.

However, oil per se is not a direct cause of Sudan conflicts, yet the oil factor furnished an important base for negotiating the CPA, sealed in 2005, and the distribution of the natural resource rents was enshrined in the Wealth Sharing Protocol. This is one of the few cases where the conflicting parties agree on a clear formula for sharing the resource rents and embark in the peace consolidation, however, sanctions and pressures from the international civil societies continue, which send a vexing message.

Sandra (2004) pointed out that many Western-based OMNCs operating in crude oil production in Africa use strategic philanthropy so that they can relate directly to local communities and so avoid pressure from civil society. Investment in Sudan's oil is the

largest overseas energy project of COMNCs; seen through the LLL framework, the venture provided them with learning and a test-bed for future FDI. Equally importantly, China's oil companies also started to follow the strategic behaviour of the Western giants, for instance, by 2009, US\$ 35 million was donated by these firms for public welfare projects in upstream areas in Sudan.

#### **8.4.5 The Spillover Effects of China's FDI**

China's oil investments incorporate transfer of technology into the upstream operations as well as downstream in refineries and oil export infrastructure. In addition, training of local staff in oil industry is included in the extraction agreement. Outside the oil sector generally, China transfers to Sudan simple technology, often labour intensive and not subject to the complication of the 'year models', which tend to reduce the costs of inputs. Moreover, an opportunity is opened up for local firms to benefit from linking to imported inputs sources, especially in advertising by linking up with the Chinese private firms. Firms in the construction sector start to imitate their Chinese counterparts, for example, many domestic firms converted to use the system of pre-fabricated blocks for roofing (Ali, 2006). Also key Sudanese firms enter in joint ventures with the Chinese firms, others benefited from subcontracting. As pointed out, Danfodio Holdings has further transnationalised with a Chinese counterpart.

### **8.5 DISCUSSION**

The broad objective of the study was to examine the impact of the recent upsurge of China's investment in Sudan in terms of its positive and likely negative effects, in order to identify areas where policy can best capture the benefits of this venture, while addressing the potential challenges. Data drawn from secondary and primary sources are used for the purpose. The Dunning OLI framework and its various extensions were used in understanding the behaviour and motivations of the Chinese firms investing in Sudan. Tabular analyses were used to highlight the scale of operation of these firms in terms of sectoral distribution; value addition; structure of ownership; market orientation; spillover/backlash effects; employment and capacity development; use of local input; development of supply chains; contribution to technological transfer, and augmentation of local firms.



The main result of the study is that about 98% of China's investment since 1996 is oil-seeking and was carried by SOEs. The investments of these companies have augmented the technological and financial capabilities of Sudan oil sector, attracted mainly by the booming economy, and concentrates on the service sector. Notwithstanding the size of this investment, it was carried out by a large number of private Chinese SMEs emerging as 'second movers', encouraged by the presence of the SOEs and the space created by the oil boom.

Oil export has substantially contributed to the national economy; arguably it mirrors the advent of the Gezera scheme. Real GDP showed strong growth over 1999-2010 with the rate of growth averaging 7.9%. Oil revenues contributed by more than 50% to central budget and the Government of South Sudan completely depends on these revenues. In addition to the direct FDI-trade complementarity, the economy indirectly benefited from the resultant relief of the energy constraint on domestic production.

Oil investment has also benefited and strengthened local firms. Five big companies, by Sudan standards, were involved in the provision of oil service. Two of these firms, Danfodio Holding Co. and Hijilig Oil Co., worked jointly with other Chinese companies in providing services for the construction of Merowe Dam. Danfodio Holdings, which is the largest commercial and construction company in Sudan with 12 subsidiaries, has implemented 35 contracts with Chinese firms. The company even internationalises in joint venture with China's Transtech Engineering to build a US\$ 634 million railways project in Mauritania.

The licensed private Chinese firms were attracted mainly into manufacturing, followed by the service sector. Oil wealth has generated a shift, though limited, in urban demand away from the basics toward manufacturing and services, which created a space for these firms. Unlike the SOEs in the oil sector, their activities were more labour intensive.

The surge in China's FDI in Sudan was made possible by the sustained increase in demand for commodities worldwide over the last decade and by the vibrant industrialisation process in China. The liberalisation policies pursued by several countries, including Sudan and China, have created an enabling environment for the movements of FDI, trade and other financial flows. Over the last decade, Sudan

remains committed to macroeconomic reform, and introduced a series of investment promotion Acts which, since 2002, have been coordinated and implemented by the Ministry of Investment.

Hence, the open door policies upstream and downstream, the need for resources, the historic relations, and China's stance on non-interference, smooth the progress of its companies in Sudan.

Contrary to the general perception, the Chinese resource-seeking companies are not the only OMNCs operating in Sudan. Many firms were engaged in upstream production and related services. A large number of private Chinese SMEs were engaged in various activities outside the oil sector in persuade of profitable opportunities, and if employment is the only measure of size they are even larger than the OMNCs operating in Sudan combined. Gu's (2009) study, drawing data from comparator countries, showed that the Chinese private firms were pushed out, not by state incentives, but by fierce competition at home and low profit margins.

China's FDI in Sudan is bundled in developmental aid, soft loans as well as debt cancellation, and this is not only explained by China's 'new model' of catalysing its investment, but equally by the fact that the country was dropped from the list of the major Western donors since 1996.

However, China's aid facilitated the implementation of key infrastructural projects in electricity, roads, bridges and water, which are important for improving the investment climate. In all of the key aid projects, Chinese companies' work jointly with domestic firms, for example in the case of the Merowe, dam the joint venture included many local and other foreign firms.

Sudan faces the challenge of mitigating the risks of the resource Dutch disease. The country is still a small producer of oil. Agriculture remains the main backbone of the economy in terms of employment generation and production of food staples. However the contribution of this sector to the real GDP, along with manufacturing has declined by more than 6% since the advent of oil. Currency appreciation resulting from the integration of oil money into the economy reduces the competitiveness of non-oil exports, leading to reduction of output and employment, particularly in agriculture.

## **8.6 CONCLUSION**

Since the US implemented its boycott of Sudan, Sudan lost considerable financial flows as well as grants and technical assistance, whether from Europe, or from regional or international financial institutions. Moreover, Sudan was considered a country which hosted terrorism. The drying up of grants, technical assistance and FDI from Europe greatly affected many projects earmarked to assist the rural people of Sudan. Within this narrow framework, Sudan found no alternative except to take dramatic measures to move towards friendly nations in order to encourage FDI.

This chapter has explained the role of FDI from China to Sudan, and discussed the direction of Sudan towards countries of South East Asia instead of Western European countries, the US and Arab countries, examining the impacts of oil in enhancing economic development in Sudan.

An explanation was firstly given of the importance, growth, structure, trends and distribution of Chinese investment, trade and aid and development assistance to Sudan. Following this, a historical background about the structure, investment, exploration and production of oil in Sudan was given, and the role of China in investment in the oil sector in Sudan was discussed. The various positive impacts of FDI from China were examined, as well as the opportunities for development in Sudan's economy; this includes the impacts of oil in satisfying domestic consumption and the achievement of self-sufficiency, and the impact of oil in increasing government resources. Also examined were the impacts of FDI on Sudan's economic growth as measured by growth in GDP.

In addition, the impacts of FDI on foreign trade as measured by the volume and structure of exports, the impacts of FDI in the balance of trade and balance of payments, and finally the impacts of oil in improving Sudan's relationship with external regional and international financial institutions were examined. After explaining the positive impacts of oil and the opportunities for development in Sudan, the negative impacts of oil and the challenges of development in Sudan were highlighted. These include high volatility and the risk of dependence on highly fluctuating oil prices in the international market, and unsustainable oil revenues.

Finally Chinese-Sudanese political and economic relations were discussed. China makes no such discrimination in its partnership with Sudan. Instead, China sees the reduction of Western influence as an opportunity to deepen alliances for both economic and political benefits. China has moved in to fill the void created by the absence of major Western powers in countries such as Sudan.

## **Chapter 9**

### **SUDAN'S OIL MARKET**

#### **9.1 INTRODUCTION**

Sudan is a country relatively rich in natural resources, and heavily dependent on natural resources for foreign exchange earnings. From 1999, the commercial production and export of oil started to increase in importance. In general, an estimation of the potential oil reserves often involves economic as well as political considerations. However, oil reserves were estimated at 5 billion barrels with live time value of US\$ 30 billion. Sudan currently is producing 480,000 barrels per day (Elbadawi, 2005).

Oil production has attracted a considerable amount of FDI into the economy. Sudan is now the fourth largest recipient of FDI in Sub-Saharan Africa; these inflows are associated mainly with oil production. FDI increased from US\$ 0.4 million in 1996 to US\$ 3,541 million in 2006, about 9% of GDP (UNCTAD, 2007).

The oil discoveries in Sudan in the late 1970s have aggravated the political and economic situation in Sudan. The oil discoveries played a pivotal role in igniting the second civil war in 1983 and jeopardised the possibilities for peace between the south and north as they became the central objective for the fighting parties. However, a comprehensive peace agreement resulted in government being able to develop resources for the benefit of the people. In addition to that, the change in US policy towards Sudan was mainly related to the oil-related developments in Sudan.

This chapter focuses on the impact of oil industry on Sudan's economy and the analysis in this chapter is based on the examination of the FDI effect on Sudan's economy during the decade 1997–2007. In this chapter, the FDI effect refers to the phenomenon that the initial Chinese investment in Sudan's oil industry brought; the direct effect of large revenues and the indirect effect of industrial linkages. The subsequent re-investment of the oil revenue by the Government of Sudan and the diversification of foreign investment into non-oil sectors led to other industries taking off, and the emergence of domestic investment and local entrepreneurs.

It should be mentioned here that Sudan has many more valuable natural resources apart from oil. Its mineral wealth includes significant reserves of uranium, copper, diamonds, gold, iron ore, mica, silver, talc, tungsten, uranium and zinc. Sudan's total land surface amounts to 2.51 million square kilometres, of which about half would support cultivation. However, only 170,000 square kilometres is actually being used for cultivation. Sudan also has a strategic position on the Red Sea. The Sudanese potential for development is, therefore, vast if the government could encourage more FDI so its resources could be fully used for the benefit of the Sudanese people and the development of the country in general.

## **9.2 MULTINATIONAL COMPANIES DOING BUSINESS IN SUDAN**

Oil exploration in Sudan was first initiated in 1959 by Italy's Agip oil company in the Red Sea area. Several oil companies followed Agip into the Red Sea area but none were successful in their exploration efforts. After the end of the first civil war in 1972, it became possible to extend the oil exploration to southern Sudan. In 1975, the US oil company, Chevron, was granted a concession in the south and south-west of the country. The first oil discovery in Sudan was made by Chevron in the south of Sudan in 1979, west of the Muglad. Chevron continued its successful exploration and made more significant discoveries in the so called Unity and Heglig fields. In 1983, Chevron, Royal Dutch Shell, the Sudanese government, and the Arab Petroleum Investments Corporation (Apicorp) formed the White Nile Petroleum Company in order to build an oil pipeline from the Sudanese oil fields to Port Sudan on the Red Sea. The projected costs for this project amounted to US\$ 1 billion. The plans of Chevron could not be implemented as the second civil war erupted in 1983. Chevron suspended its operations in 1984 and ended its 17 year involvement in Sudan completely by selling its interests to the Sudanese company Concorp in 1992. Concorp sold these concessions on to the Canadian oil corporation, State Petroleum Corporation, a few months later. In 1994, Arakis Energy Corporation purchased State Petroleum Corporation and started operating in Sudan. Arakis faced difficulties in securing the needed financing to fulfil its exploration and production agreement with the Sudanese Government. In 1996, it sold 75% of its shares to the China National Petroleum Company (CNPC), Petronas (Malaysia), and Sudapet (Sudan), with which it jointly formed the Greater Nile Petroleum Operating Company (GNPOC). Arakis

subsequently sold its 25% share in the GNPOC to the Canadian company Talisman in 1998.

The GNPOC made considerable discoveries, increasing the amount of proven reserves in Sudan. It also succeeded in the construction of the pipeline from the Heglig and Unity fields to Port Sudan on the Red Sea. In 1999, the pipeline became operational and carried the first Sudanese oil exports to Port Sudan. In this period, and as a result of international public pressure over accusations of being complicit in human rights violations through its operations in Sudan, Talisman sold its shares in the GNPOC to the Indian company Oil and Natural Gas Corporation (ONGC).

A consortium made up of the French company Total, the US company Marathon, Kuwait Foreign Petroleum Company and the Sudanese company Sudapet was granted a concession in south eastern Sudan (block B) in 1980. The consortium suspended its operations in 1985 as a result of the civil war. Unlike Chevron, Total and its partners did not relinquish their concessions as a result of the civil war and they signed an agreement in December 2004 with the Sudanese government to update the contract. As a result of this, there is now a dispute between Total and a UK company, White Nile Ltd, who claims that it signed an agreement with the future government of south Sudan for oil exploration in part of the land believed to be within block B and part of the concession of Total and its partners.

In 1997, the Sudanese Government granted another concession in the so-called block 5A to the Swedish company Lundin with partners Petronas, OMV (an Austrian oil and gas company) and Sudapet. In 2001, the same consortium was granted a concession over block 5B. In 2003, Lundin sold its interest in block 5A to Petronas, and OMV sold its interests in blocks 5A and 5B to the Indian company ONGC.

Petrodar Operating Company (PDOC) is an operating company working in the industry of exploration, development and production of crude oil. It operates blocks 3D, 3E, and 7E which are located in the south east of Sudan, with a total concession area of 72.420 square kilometres. The company is incorporated under the laws of the British Virgin Islands and has a registered branch in Sudan.

The blocks were originally awarded to Chevron, which discovered about 123 million barrels of oil in the Agordeed and Adar-Yale fields. The blocks were then returned to the Government of Sudan and awarded to a consortium composed of Gulf Petroleum Company (45% of the participating interest in the contract area), a company incorporated under the laws of Sudan, Melut Petroleum Company (45% of the participating interest), a company incorporated under the laws of Sudan, and Sudapet (8% of the participating interest), a company fully owned by the Government of Sudan. On March 2000, an exploration and production sharing agreement was concluded between the consortium members from one side and the Government of Sudan from the other.

On November 2000, an amendment to the exploration and production sharing agreement was made, Melut Company equity was assigned to CNPC and to Al-Thani Corporation, a company incorporated under the laws of the UAE.

According to a BP statistical review of world energy in 2006, Sudan has a proven oil reserve of 6.4 thousand million barrels. The oil exploration has been limited to the central and south central regions. It is estimated that the country holds vast potential reserves in the east, north-west and south of the country.

In 1999, the construction of an export pipeline was completed that connected the Heglig oil fields in central Sudan to Port Sudan on the Red Sea. This led to a considerable increase in oil production, and the first oil export in the history of Sudan. Since then production has increased steadily. In April 2006, another 1,400 kilometre pipeline became operational, from Upper Nile in Sudan's south-east to Port Sudan. This pipeline raised production to 500,000 barrels per day in 2006 and doubled production in 2007.

CNPC is involved in several projects in Sudan. It has a 40% share in GNPOC, which owns the rights in blocks 1, 2 and 4 (Heglig and Unity fields), and a 92% interest in block 6. In addition, CNPC has a 41% share in the Petrodar Consortium which owns concessions in blocks 3 and 7 and 35% in block 15. Petroliaam Nasional Berhad (Petronas), a state-owned Malaysian company, has a 30% interest in GNPOC, a 40% interest in the Petrodar Consortium (blocks 3 and 7), a 68.875% share in block 5A, 39% in block 5B, 77% in block 8, and 35% in block 15.



ONGC, a state-owned Indian company, has a 25% interest in GNPOC, 26.125% in block 5A and 23.5% in block 5B. Lundin Petroleum, a Swedish company, has a 24.5% interest in block 5B. The French company Total has a 32.5% interest in block B. The US company Marathon Oil Corporation has 32.5% interest in block B. Kuwait Foreign Petroleum Company has a 25% interest in block B. Cliveden, a Swiss company, has a 37% interest in block C. Express Petroleum of Nigeria has a 10% interest in block 15.

### **9.3 CHINESE INVESTMENT IN THE OIL INDUSTRY IN SUDAN**

Poverty has been a consistent challenge for Sudan. Its per capita GDP was US\$ 38 in 1997, when CNPC started its oil investment in the country. Physical infrastructure is generally inadequate. Institutions are among the most diverse due to the geographical, ethnical and political division among its population. At the same time, the country is among the wealthiest in terms of natural resources, not only oil, but also minerals, water and agricultural land. It has substantial potential for rapid infrastructure, industrial and service development. This provides enormous business opportunities for local firms and TNCs. FDI in Sudan's oil industry can be traced back several decades; oil majors such as Chevron explored for hydrocarbons but eventually gave up due to the civil war and the failure to meet the demand from the host government to speed up oil extraction.

China's engagement in Sudan started as early as the 1970s, mainly providing aid and loans for non-commercial purposes. China provided a total of US\$ 89.3 million in aid and loans to Sudan in the 1970s and 1980s (Ministry of Finance, Sudan, 2008), when the Chinese economy was still relatively poor. The bilateral relation was cooler during the 1980s when China's leadership shifted its policy to focusing on domestic development. In the early 1990s, it was the Government of Sudan that initiated a renewal of the relationship with China, which led to a close commercial tie between the two countries.

While FDI by Chinese firms (excluding oil investment) between 2000 and March 2008 was US\$ 249 million, bilateral trade between Sudan and China rose from US\$ 103 million in 1990 to US\$ 9.7 billion in 2007 (Central Bank of Sudan, 2008, 2010). The accumulated aid and loans amounted to US\$ 23.47 billion by 2006 (Sudanese

Ministry of Finance, 2008). In 2010, China was Sudan's largest trading partner while Sudan was China's third largest trading partner in Africa, after Angola and South Africa. The first delegation invited by the Government of Sudan to explore investment opportunities visited Sudan in 1995. This visit included a tour of the Zhong Yuan Oilfield, later developed by an affiliate of CNPC. Table 9.1 illustrates the variety of Chinese investment into Sudan.

**Table 9.1: Chinese Direct Investment in Sudan (non-oil)**

<b>Year</b>	<b>Project (employees)</b>	<b>Amount (US\$)</b>	<b>Industries</b>
2000	5	38,440,451	Petrochemical service stations, Roads and bridges (2), Computer assembly, Bricks
2001	1	200,000	Leather products
2002	2	1,531,800	Furniture, Plastic products
2003	3	12,071,850	Leather products, Furniture, Lighting bulbs, Plastic products (2), Leather products, Garments
2004	8 (414)	10,889,933	Food (2), Oxygen supply, Building material manufacture (2), Steel manufacture, Building material manufacture
2005	12 (828)	46,376,952	Plastic products (2), Poultry and vegetables(2)  Earth moving, restaurant, roads and bridges (3), Construction equipment  Transportation (3), Advertisement, Soil analysis, Construction (2), Irrigation, Plastic products (3)

<b>Year</b>	<b>Project (employees)</b>	<b>Amount (US\$)</b>	<b>Industries</b>
2006	17 (1,141)	97,178,745	Construction equipment, Medical equipment, Mining, Computer equipment, Furniture, Car component manufacturing and engineering, Car service (4), Construction (2), Transportation, Hotel, Media and advertisement, Farms (2)
2007	22 (16,115)	33,574,420	Poultry products, Engineering workshop (2), Steel, Plastic products (3), Mining (2), Cement, Garments, Irrigation, Agricultural products, Miscellaneous
2008	4 (386)	8,530,039	Flooring and blankets, Plastic products
2000-2008	74	248,794,190	

*Source:* Ministry of Investment, Sudan (200B). Interpreted from Arabian language and then categorised by the author with assistance of her colleague

### **9.3.1 Investment of CNPC in Sudan: Capability, Strategy and Mindset**

CNPC is China's largest producer and supplier of crude oil and natural gas, accounting for, respectively, 57% and 80% of China's total output in 2010. It is also a major producer and supplier of refined oil products and petrochemicals, second only to SINOPEC. CNPC started its foreign expansion in 1993 but made no significant progress until 1997, when it acquired large stakes in Kazakhstan, Peru and Sudan. By 2010, CNPC had about 80 overseas projects in 29 countries. It is now ranked sixth among the world's largest petroleum companies.

CNPC's capability is closely related to its dominant position in China's oil and gas industry, inherited from two major restructurings within China's oil and petrochemical industries. Before the 1980s, China's entire oil and gas exploration and production was controlled by the Ministry of Petroleum Industry. In 1988, the State Council dissolved this ministry and established CNPC to take control of its assets.

The assets CNPC owned then were mainly upstream, as SINOPEC was to control the downstream assets. This arrangement continued until 1998, when both companies were allocated assets covering upstream and downstream.

With over 50 years' operation, CNPC possesses unique and advanced petroleum technologies, which supported the development of the Chinese petroleum industry as well as its overseas projects. In Sudan, for example, by using technologies developed in China for passive rift basins and under-explored basins, CNPC made a discovery of five billion barrels of oil in block 3/7 of the Melut Basin, a basin abandoned by western companies (chief executive of CNPC Nile interviewed on 21 April 2009, Khartoum).

Another important capability which assisted CNPC to win contracts was its ability to provide products and services at a lower price, or in difficult circumstances, even in under-developed countries such as Sudan which were experiencing military conflict. The lower price was based on cost advantages, with costs a third less than the Western bidders in some cases. This was particularly attractive for developing host countries with 'too little money for too many unfulfilled projects' (anonymous Sudanese interviewee, 2009).

While TNCs are often accused of lacking the mindset to serve the 'poor' (Prahalad, 2010), CNPC has many reasons to locate in the poorer countries and serve the poor, as evidenced by examples such as establishing the refinery and petrochemical industries so as to allow the host country to climb up the oil industry value chain.

This was influenced by its strategic intent of internationalisation (Rui & Yip, 2008). As the investment in Sudan was initiated by the two governments, CNPC was therefore expected to be locally responsive in order to maintain the close relation between the two countries. At the same time, when resource nationalism makes global competition for oil reserves more intense, CNPC has to grasp any opportunity to increase its oil reserves and equip itself with international standards of technology, health and safety, and corporate social responsibility in order to win international contracts.

On 29 November 1996, the four partners from Canada, China, Malaysia and Sudan signed a draft production sharing agreement with the Government of Sudan for the exploration and development of block 1/2/4 oilfield. In 1997, GNPOC was established as a consortium, formed by CNPC, Petronas, and Talisman Energy (which sold its share to the Indian state-owned company, ONGC, in 2003), and Sudapet (representative of the host government). Based on the shares they held, which was 40%, 30%, 25% and 5% respectively, CNPC became the operator of GNPOC. By 2008, CNPC had invested in seven projects in Sudan, including four oil exploration and development projects, one pipeline, one refinery, and one petrochemical project, worth an estimated US\$ 5 billion (official at the Ministry of Energy and Mining, interviewed on 2009, Khartoum).

## **9.4 DIRECT AND INDIRECT IMPACTS OF CNPC'S INVESTMENT IN SUDAN**

### **9.4.1 Direct Impacts**

The direct impacts that CNPC's investment has made on Sudan are best represented by the huge revenue the country has received. The first barrel of oil was produced and exported from Sudan in 1999. Sudan's revenue rose substantially year by year between 2002 and 2008 with the increasing oil output and price (Table 9.2). Researcher interviews in May 2010 regarding the declining global oil price and its impact revealed interesting facts. Sudan was impacted relatively little by the fall in the oil price after 2008, because its oil exports were managed under long-term contracts in which the price paid for oil export from Sudan gradually increased, irrespective of the world market price, ensuring the stability of oil income.

Compared with the financial crisis, the presidential election in 2010 was perceived to have a far more negative impact on Sudan's economy in 2009 and 2010, as reflected in the data for year 2009 in Table 9.2. Given the unpredictable result of the election, business activities including FDI 'almost came to a standstill' before and during the elections (Sudanese entrepreneur interviewed in 2010).

**Table 9.2: The Sudan Economy in Figures, 2002-2009**

<b>Year</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Population (million)	32.7	33.6	34.5	35.4	36.3	37.2	39.2	40.3
GDP per capita (US\$)	474	572	619	703	831	1,247	1,480	1,356
Inflation %	8.3	7.7	8.5	8.5	7.2	8.1	14.3	11.2
Growth rate of GDP (% , at current prices)	6.5	6.1	9.1	8.3	9.3	10.2	6.8	4.5
Exports ( FOB) (US\$ million)	1,949	2,542	3,777	4,824	5,656	8,902	12,480	7,834
Imports ( FOB) (US\$ million)	2,152	2,536	3,586	5,946	7,104	7,722	9,097	8,528
Agricultural sector contribution to GDP %	46.0	45.6	39.2	26.6	39.2	28.9	31.0	31.2
Industrial sector contribution to GDP %	23.1	24.1	28.0	33.3	28.3	33	31.4	23.8
Services sector contribution to GDP %	30.9	30.2	32.8	40.2	32.5	38.1	37.6	45
Governmental revenue (US\$ million) (2)*	2,991	2,814	4,095	4,873	6,030	9,578	12,635	8,504
Southern Sudan net oil revenue shares (US\$ million)				814	1,216	1,662	2,938	1,060

*Sources:* Central Bank of Sudan, 2008 May 2010. \*converted from Sudanese Pound (SDG) at US\$ = 250 SDG

### **9.4.2 Indirect Impacts**

The indirect impacts of CNPC's investment in Sudan are best represented by its linkage effect. FDI in oil is often criticised for contributing little to development due to limited linkage opportunities. Because of the large volume of investment involved and the relatively low transportation costs of the end products, oil majors have been reluctant to establish petrochemical plants in developing countries (Oman & Chesnais, 1989). It has been difficult to encourage oil TNCs to develop downstream activities where and when it is in the host country's long-term economic interests. In this regard, CNPC's impact on Sudan's economy arises not only from its oil exploitation, but also from its petrochemical business.

As early as March 1997, CNPC and the Government of Sudan officially signed the general agreement on jointly investing in and constructing Khartoum Refinery Company (KRC) with each party holding a 50% share. KRC began its operation in 2000, with a refinery capacity of 2.5 million tons, which was expanded to 5 million tons by 2006. The refinery was entirely designed and constructed by Chinese firms, with key equipment brought from China, France and Germany.

CNPC acquired international technology to deal with wasted oil at this refinery to meet the environmental standards set by the host country as well as the international standard. Its production capacity can meet the demand of, not only the entire country of Sudan, but also a small amount of export. Petrol stations in Khartoum are run by a wide range of global companies including Shell, Petronas and CNPC, offering much lower prices than the global market. According to the Agreement signed by the two sides, CNPC was required to transfer all its technology required for the operation of KRC to local enterprises within eight years. To meet this requirement, training for local employees was provided in Sudan and China. A Chinese executive admitted that this was a difficult task, and was concerned about the safety of the refinery after the transfer. According to this executive, the problem was due to the country not having experienced industrialisation and to the lack of public understanding of factory disciplines.

Petrochemicals are considered an important downstream business of the oil industry, and key to providing inputs for diverse industries, leading to the development of

manufacturing. CNPC helped establish Khartoum Petrochemical, alongside the refinery. At the peak time, 340 employees worked at the factory, of which 89 were Chinese, 35 Bangladeshi, and 216 local. One Sudanese employee stated that he resigned from his previous primary school teacher position to work in this factory because of the higher salary. He was paid US\$ 300 per month given his site manager role, while his Bangladeshi colleague was paid US\$ 250 per month and drivers US\$ 800–900 per month. Although still small (52 tons/day) this factory is already able to meet the domestic demand for woven sacks. The executive revealed that the factory would soon be expanded in order to develop ethylene products, another high demand business in Sudan.

There are other linkage effects, too. With the increased development of the oil and petrochemical industry in the country, domestic firms have grown and played complementary roles. The oil consortium for block 17 was led by the Sudanese, the CEO worked with GNPOC and is able to operate this new oil consortium. The service company Red Corporate, the CEO of which was also a Sudanese working in GNPOC, provides project management services to large oil companies, previously just in Sudan but now in other African countries as well. This further stimulates the increase of equipment suppliers such as DAL Group, the top indigenous private company in Sudan.

Interestingly, many highly qualified and experienced Sudanese living abroad have returned to the country since 2003 to explore the opportunities in the booming domestic economy. Table 9.3 demonstrates the rapid rise in domestic investment from 2000, especially in the industrial and service sectors, indicating linkage effects.

## **9.5 DIVERSIFICATION EFFECT AND THE CASCADE EFFECT IN NON-OIL INDUSTRIES**

The previous literature claims that the resource ‘curse’ could be overcome and development would be achieved if the host government were able to use the resource income wisely, e.g., establishing oil stabilisation funds and diversifying FDI to important non-oil industries.



**Table 9.3: Capital Invested by Sudanese and Foreign Investors, 2000–2009 (US\$ million)**

		<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>By Foreign Investors</b>	Industrial	287	696	399	1,083	1,458	2,967	3,123	4,757	8,435	3,847
	Services	579	931	778	1,908	2,026	6,372	7,079	6,429	11,212	2,941
	Agricultural	20	25	12	38	36	184	144	108	252	97
	Total	886	1,652	1,189	3,029	3,520	9,523	10,346	11,293	19,897	6,885
<b>By Sudanese</b>	Industrial	73	426	566	351	348	973	1,669	3,037	1,025	845
	Services	229	281	344	275	527	2,216	1,115	1,603	3,951	1,917
	Agricultural	10	3	57	156	4	16	200	381	176	653
	Total	312	710	967	782	879	3,205	2,984	5,020	5,151	3,414

*Sources:* Ministry of Investment May 2010

The Government of Sudan has set up a stabilisation fund, the Oil Revenues Stabilisation Account, which, by late 2008, was among the 50 largest such funds globally. Meanwhile, during the last decade, a wide range of projects have been started or completed by government re-investment of the oil revenues. Among the Government Development Programme between 2000 and 2005, investment in agriculture was increased from US\$ 6 million to US\$ 47 million; in infrastructure from US\$ 2.5 million to US\$ 17 million; in social welfare, including education and health, from US\$ 1.4 million to US\$ 7 million (Ministry of Finance, 2008). In addition, as the booming economy attracts a new influx of foreign and domestic investment, the government has encouraged investors to enter non-oil industries.

## **9.6 OIL REVENUE STABILISATION ACCOUNT**

In oil-rich developing countries, the oil industry is playing an increasing role in how a country's oil and gas is extracted, where the revenues go, and how the general public will benefit. An oil fund is considered important for managing oil revenues for long-term development, as well as for overcoming the 'Dutch disease' of rising exchange rates that could choke off non-oil industrial development.

One function of an oil fund is to keep the economy stable by making investment expenditures within the economy counter-cyclical. In practice, developing countries such as Sudan are expected to keep a large proportion of their natural resource funds in safe foreign investments (e.g., US dollar bonds), as it preserves their value and avoids the risk of currency appreciation. The econometric estimation results from a 30-year panel dataset of 15 countries with or without an oil fund, suggests that oil funds also deliver macroeconomic benefits, being associated with reduced volatility of broad money and prices, and lower inflation (Shabsigh & Ilahi, 2007).

Oil has its importance in Sudan. Oil reserves were estimated at 5 billion barrels with live time value of US\$ 30 billion. Sudan currently is producing 480,000 barrels per day (Elbadawi, 2005). Between 1999 and 2009 the percentage contribution of oil production to overall exports averaged about 90%. The data also reveals that the contribution of non-oil exports showed a net decline from its level in 1999. Aside from the volume growth, Sudan exports faced a declining world price. For example,

the world price of cotton, the main traditional export in Sudan, declined by 10% per annum over the 1990s. The prices of other exports, namely sesame and sorghum, have also declined, due to the Asian crisis of 1997.

Oil production has attracted a considerable amount of FDI into the economy. Sudan is now the fourth largest recipient of FDI in Sub-Saharan Africa; these inflows were associated mainly with oil production. FDI increased from US\$ 0.4 million in 1996 to US\$ 3,541 million in 2006, about 9% of GDP.

Under the current Comprehensive Peace Agreement, which ended the two-decade long civil war in 2005, the oil revenue from these fields are shared, almost equally, with oil-rich border states of Abyei, Blue Nile and South Kordofan sharing 2% of all oil revenues for themselves. The remaining 98% of oil revenue is shared between the national government and the government of the Southern Sudan. Export proceeds are outlined in Table 9.4.

**Table 9.4: Sudan Crude Oil Exports Proceeds, 2006-2009**

<b>Year</b>	<b>Volume (barrel)</b>	<b>Value (US\$ million)</b>
<b>2006</b>	45,062.88	2,313.183
<b>2007</b>	176,573.858	3,225.02
<b>2008</b>	109,969.372	4,877.00
<b>2009</b>	83,349.528	0609.189

*Source:* Ministry of Finance

Oil revenues represented more than 65% of the government revenue and more than 90% of the revenue of the government of Southern Sudan. Oil revenues have already made an impact, paying for roads, bridges and hydropower dam projects that the country desperately needs.

Oil revenues have been increasing over time, for example, the ratio of oil revenue to the GDP rises from 0.6% in 1999 to about 10% in 2003 and are expected to be higher

in the near future. Oil revenues have also been an important source of revenue for the federal government. In 2000, the first year of full production, oil revenues contributed by about 43% to the total federal revenues (World Bank, 2003).

Oil production has other indirect impacts on GDP growth through its effects on easing the power constraints and hence improving capacity utilisation. It has been estimated that about 85% of small industrial firms in Khartoum State work below capacity due mainly to power shortages and limited access to fuel; with increased access to fuel this constraint is less binding on capacity utilisation and growth (World Bank CEM, 2003). Other positive effects of oil production include the increased work opportunities generated in the services and manufacturing sectors.

Since the completion of the pipeline in 1999, Sudan oil production and export have increased rapidly. The growing importance of oil revenues and the dependence of the country on commodity export remaining high, in the future are expected to make the country vulnerable to commodity price shocks. This issue arises not only in the context of future oil revenues, but also with regard to maintaining the hard-won recent macroeconomic stability and managing of the economy in the peace era.

The Government of Sudan set up its Oil Revenue Stabilisation Account in 2002, with an asset amounting to US\$ 24.6 million in 2007, US\$ 122.4 million in 2009, and an estimated US\$ 122.4 million by April 2010 (IMF; Ministry of Finance, cited in Lim, 2010). There is no evidence that the Government of Sudan has used this account for current spending. There has been international scrutiny on Sudan's oil revenue and its role in the civil conflict. Setting up such a transparent fund would be positive for the country in its effort to attract donors (Melby, 2002).

As of 2002, Sudan had 5,995 kilometres of rail track but more than 90% of the track was out of use due to civil war damage and lack of maintenance. The overall road system was 11,900 kilometres, of which 4,320 kilometres was paved, in a country of 2.5 million square kilometres. Crucially, there was only one major road, the Khartoum-Port Sudan road, which accounts for 1,197 kilometres and was completed in 1980. However, Sudan's infrastructure construction began to speed up in 2002, due not only to the rising oil revenue, but also to the availability of international investment and loans for which oil export was a pre-condition. Another high quality

road between Khartoum and the Merowe Dam, stretching more than 2,000 kilometres, was completed in 2008. Port Sudan, the sole port of the country, has been upgraded. Several power plants have been constructed and put into use, leading to a lower frequency of power cuts.

The project of the Merowe Dam on the Nile is a case in point. This is the largest hydropower project in Africa. The purpose of the project is power generation, water supply for irrigation, and flood control. By 2005 in Sudan, a power generation capacity of only 600 MW was available for about 35 million people, which was less than 20 Watts per person. Insufficient funding and the lack of investor interest stalled the project for several decades. After 2000, a greatly improved credit rating brought an influx of foreign investment. The total investment (including spending on migration) was estimated about 4 billion Euros, of which a large proportion was funded by foreign investors (Table 9.5).

**Table 9.5: Major Investors in Merowe Dam Construction Project\***

No	Investor	Fund (in US\$ million)
1	Government of Sudan	575
2	Government of China	520
3	Arab Fund for Economic and Social Development	250
4	Saudi Fund for Development	200
5	Abu Dhabi Fund for Development	150
6	Kuwaiti Fund for Economic Development	150
7	Sultanate of Oman	106
8	State of Qatar	15
Total		1966

Source: Merowe Dam Construction Committee, Sudan, 2010

Note: \*Funding contributors for migrations compensation due to dam construction are not listed

The contracts for the construction of the dam were signed in 2002 and 2003. The dam's power generation capacity was 1,250 MW, doubling the national capacity. Chinese company Sinohydro was contracted to construct the dam while ABB provided power equipment. At its peak, this dam construction required 5,000 employees, of which 2,500 were local. The dam was completed and started generating electricity in 2009, significantly easing the country's longstanding power shortage.

## **9.7 INVESTMENT IN AGRICULTURE**

Sudan is an agricultural country. An internal 2008 report by the Government of Sudan shows that, in 2008, agriculture provided 40% of its GDP, 65% of its employment, and 80% of its non-oil export income. Before oil export began in 1999, agricultural export was the sole source of foreign exchange. Although rich in land and water, Sudan's agriculture was underdeveloped due to the civil war as well as the lack of capital, equipment, electricity, water supply (with no adequate connections to the Nile) and technology to improve productivity (Ministry of Energy, 2008). The government has realised the importance and huge potential of this sector, stressing 'agriculture is Sudan's oil' and set year 2009 as 'Agricultural Year', together with a grand development plan for 2007–2010 to attract future investment.

Local companies, such as DAL Group, have suffered from high import prices for agricultural products which are major inputs of their food and soft drink businesses. DAL has said it is extremely keen to cooperate with Chinese companies such as China National Cereals, Oils and Foodstuffs Corporation to develop the agriculture business, possibly even a biofuel business. Chinese TNCs also play an important role in the sector by providing agricultural equipment, as seen in DAL's storage.

Furthermore, farms were set up by Chinese entrepreneurs when they realised that there is demand among Chinese workers in Sudan for certain vegetables that are not produced locally. They started to set up farms to produce these vegetables. One farm the author visited in the suburb of Khartoum was run by a Chinese woman, who came to Sudan as a doctor, but turned herself into a farmer when sensing the lack of local supply. She hired about 30 employees in her farm, who were all local except for two farm technicians hired from a Chinese agricultural science academy. She hired local employees because of 'lower cost and constraint by migration rule', as she was

allowed to hire two employees only from China. There were two other farms in Khartoum run by Chinese when she started five years ago but, by 2008, there were more than ten in the region. These farms supply agricultural goods to not only Chinese companies but also local markets.

## **9.8 DISCUSSION AND CONCLUSION**

### **9.8.1 Development Implications**

Since Sudan started to export oil in 1999, significant changes have taken place in its economy. It has one of the fastest growing economies in Africa (second only to Angola, another resource-rich country now emerging from civil war), with average annual growth rates of more than 9% between 2005 and 2009 (see Table 9.2).

By regional and even global comparison, this represents exceptional economic growth. The government is making use of the economic growth as a foundation to promote development, including setting up a resource-stabilisation fund, diversifying investment to non-resource sectors, encouraging domestic investment, installing much improved infrastructure including electricity and water supply, ending the decades long civil war with the oil revenue sharing agreement, and promoting free movement between the south and north of Sudan, which had been deeply divided as a result of European colonial intervention, long before China's arrival. It can be further demonstrated that these positive developments were achieved through the interaction between FDI and host institutions.

### **9.8.2 How Local Needs in Sudan Benefit from TNCs**

The researcher finds that investment by developing country TNCs in another developing country does provide a good fit between TNCs' goals, strategy and mindset and the development needs of the host country, as well as between TNCs and host institutions. The researcher discovered that CNPC and Sudan met each other's needs for the following reasons.

(1) Table 9.6 shows that, since 2003, China has climbed to the third position in oil importation and is now close to Japan as the second largest oil importer. Chinese imports increased rapidly from 1.9 million barrels per day in 2000 to approximately

3.8 million barrels per day in 2006 (ENI, 2008). Sudan is able to provide China WITH 8% of its total need in oil (Bank of Sudan, 2008).

(2) While Sudan has plenty of oil, it lacked the capital and capability to turn the resources into national wealth and long-term development. CNPC provided them, enabling oil exploration and the successful start of oil exports.

(3) While Sudan was under international sanctions and Western firms were reluctant to invest in Sudan, China was willing to invest, having taken into account not only the close relationship between the two countries, but also the difficulty of accessing oil resources in the global market. This latecomer disadvantage impedes CNPC's global strategy and compels it to pursue investment in areas in which longer-established TNCs have written off as geologically or politically unworkable.

(4) Concerned about developing country TNCs' less advanced technological and managerial capabilities, Sudan hires developed country TNCs to supervise developing country TNCs. It has concluded a production sharing agreement with foreign investors and applies international health, safety and environment standards to achieve both quality and cost efficiency. To avoid poor institutions harming its long-term interests in the host country, and with the strategic intent to learn international management skills, CNPC is willing to work under such supervision as the production sharing agreement also sets out obligations for host countries, e.g., providing a safe investment environment.

(5) Given the large amount of investment, CNPC has every reason to demand good governance to ensure a higher return on its investment. To do so, the company does not directly criticise the host institutions but persuades the host government to improve by demonstrating the attractive prospects of FDI's benefits to the host economy. The host government, on the other hand, has realised the 'necessary and urgent' need to establish formal laws and regulations to benefit from FDI (official at Sudanese Ministry of Energy and Mining, interviewed in 2009). For example, the Ministry of Energy and Mining published for the first time an 'Investor Manual on Energy and Mining Fields' in 2006 to inform and instruct potential investors, which also lists detailed information on oil blocks for potential investors. Furthermore, improving efficiency and addressing the problem of corruption have also been



considered by the host government as necessary for attracting potential investors and keeping existing investors in Sudan.

Most importantly, understanding that a peaceful environment is vital for attracting FDI, the government and the rebels in the south eventually signed the Comprehensive Peace Agreement in 2005, allowing the south to share 40% of the oil revenue.

Consequently, the mutual benefits brought not only much improvement to the capabilities of both sides but also a better understanding and a deeper cooperative relationship. CNPC has accumulated rich experience in working in a least-developed country, while the Sudanese have gained experience of managing natural resources and of ensuring more local benefits from TNCs.

Table 9.6 shows the top ten oil importing countries in the world.

**Table 9.6: The Top Ten Oil Importing Countries in the World**

	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
United States	9,710	10,428	10,945	11,084	11,716	12,120	11,805	12,562	13,482	13,947	13,841
Japan	5,615	5,519	5,265	5,263	5,377	5,042	5,125	5,168	5,106	5,233	5,127
China	841	1,305	1,094	1,238	1,886	1,754	1,975	2,572	3,383	3,346	3,834
Germany	2,995	2,997	3,082	2,889	2,917	2,977	2,825	2,851	2,884	2,946	2,934
Korea, Rep. of	2,514	2,849	2,664	2,827	2,934	2,851	2,694	2,666	2,720	2,697	2,823
Netherlands	1,866	1,943	1,945	1,932	2,105	2,153	2,129	2,155	2,318	2,506	2,658
India	1,076	1,142	1,267	1,488	1,667	1,714	1,775	1,960	2,077	2,218	2,464
France	2,152	2,179	2,309	2,227	2,308	2,281	2,243	2,320	2,353	2,426	2,355
Singapore	1,716	1,768	1,707	1,690	1,622	1,676	1,705	1,655	1,895	2,128	2,349
Italy	2,166	2,189	2,266	2,162	2,210	2,145	2,165	2,188	2,164	2,179	2,137
Top ten countries	30,651	32,319	32,544	32,801	34,742	34,715	34,438	36,096	38,381	39,626	40,522
Rest of the world	18,202	19,159	19,530	19,321	19,925	20,516	20,715	21,259	22,741	23,202	23,706
World	48,853	51,478	52,073	52,121	54,667	55,232	55,153	57,355	61,152	62,829	64,228

Source: ENI, 2008

### **9.8.3 The Role of Chinese Investors in the Development of Sudan**

While this chapter has provided some insights on the contribution of Chinese investors to development in Sudan, this still leaves open the question of whether this is the best option for Sudan. As noted above, China has never been the sole investor in Sudan. Before Chinese investors entered the country in the late 1990s, Western oil firms had been exploring for oil in Sudan for decades. Since the arrival of Chinese oil firms, TNCs including most of the top oil firms from developing countries have been working with the Chinese on projects such as GNPOC. As observed by the United Kingdom Department for International Development (DFID), Chinese investment in the African oil sector is growing rapidly, but it is still a small player. The accumulated investment by TNCs in Africa is US\$ 170 billion, of which China has invested just US\$ 17 billion (DFID, 2008). It is therefore reasonable to assume that other investors could also contribute to promoting Sudanese development. Indeed, besides CNPC, there are a large number of global and national oil companies investing in Sudan (Table 9.7).

Data on other relevant investors in Sudan collected for this study enable a comparative view of the Chinese contribution. To supplement past comparisons, questions comparing CNPC with Western oil firms (mainly Chevron) and other developing country oil firms (mainly Petronas and ONGC) were raised with interviewees working for the Ministry of Energy and Mining; GNPOC; local firms partnered with these firms, and the general public. Data collected indicate that Chinese investors have several features which enable them to make a unique contribution to Sudan's development.

Firstly, Chinese investors are more willing to take risks. Here, comparison with Chevron is especially revealing. Chevron was granted its oil concession in 1974 and discovered oil in 1978. The Shell (Sudan) Development Company subsequently took a 25% interest in Chevron's project. Together, the companies spent about US\$ 1 billion in extensive seismic testing and the drilling of 52 wells (Talisman Energy, 1998: 4). However, Chevron suspended its operation in Sudan by the end of 1984 and eventually withdrew. According to John Silcox, the president of Chevron's overseas operations at the time, the withdrawal was made because they did not want to expose

their employees to ‘undue risk’ in the middle of a civil war. The fact that Chevron’s employees were attacked several times by the southern rebel groups was the direct cause of the company’s suspension of operations, but interviewees in Sudan believed that the low global oil price and availability of better quality oil reserves around the world in the mid-1980s also played a part in Chevron’s decision. CNPC, on the other hand, took the risk of entering Sudan in 1995 when civil war had stopped but conflicts between the south and the north persisted.

**Table 9.7: Oil Operating Companies and Their Shareholders in Sudan**

<b>Operators</b>	<b>Shareholders; % of shares in brackets</b>	<b>Block</b>
Greater Nile Petroleum Operating Company (GNPOC)	CNPC (40%), Petronas (30%), ONGC (25%) and Sudapet (5%)	1,2 & 4
Petrodar Petroleum Operating Company (PDOO)	CNPC (41%), Petronas (40%), i hani (16%), SINOEC and Sudapet (8%)	3 & 7
White Nile Petroleum Operating Company (WNPOC)	Petronas (68.875%), ONGC (24.125%) and Sudapet (7%)	5A
Petro-Energy Operating Company	Petronas (39%), Lundin (24.5%), Sudan CNPC (95%) and Sudapet (5%)	4A
White Nile Petroleum Operating Company (WNPOC)	China National Petroleum Company, Sudan CNPC (95%) & Sudapet (5%)	6
White Nile Petroleum Operating Company (WNPOC)	Petronas (77%), Sudapet (15%) and Hi Iech (8%)	8
Sudapak Operating Company	Zaver Petroleum Co. (85%) and Sudapet (15%)	11 & 9A
Sahara Oil Company	Alqohtani & Sons (33%), ANS'AN WKIFS (20%), and Sudapet (20%)	12A
Coral Petroleum Operating Company	CNPC Red Sea, Pertamina, AfricaEnergy, Express Oil, Sudapet and Dinder Grauo	13

<b>Operators</b>	<b>Shareholders; % of shares in brackets</b>	<b>Block</b>
Salima Oil Company	PetroSA (80%) and Sudapet (20%)	14
Red Sea Petroleum Operating Company (RSPOC)	CNPC, Petronas, Sudapet, Hi Tech. Nigerian Express Oil	15
International Petroleum Company in Sudan Limited (IPSL)	Owned by Lundin (100%)	16
Star Oil Company	ANSAN WIKFS (66%) and Sudapet (34%)	17
TOTAL Exploration - Sudan	Total Exploration (32.5%), Marathon Petroleum 32.5%), Kuwaiti Foreign Petroleum Exploration Co. (25%) and Sudapet PC (10%)	B
Advanced Petroleum Operating Company (APCO)	PanEnergy Oil & Gas (32.5%), Hi Tech (32.0%), Sudapet (17%), Khartoum State (10%) and Heglieg (8%)	C

*Source:* Oil Exploration & Production Authority, Ministry Of Energy & Mining, Sudan 2008.

The Chinese employed a different approach to dealing with the risk, including encouraging the peace process and sharing the oil revenue between the rebels in the south and the government. Most Chinese interviewees, including the Commercial Consul, believed that poverty is the fundamental cause of the conflicts in Sudan, and stimulating economic development will contribute to the peace process if a fair deal on oil revenue sharing could be reached.

Secondly, Chinese TNCs are willing and able to work on low-margin projects, which enable the Sudanese to implement more affordable projects. Chinese bidders for sub-contracts in the oil and infrastructure sectors could offer prices one-third lower than their Western, and even Malaysian and Indian, counterparts. This was further supported by the lower cost of labour and equipment in China. For example, CNPC's engineers in Sudan are paid less than one-third of the salary of their Western counterparts, such as Schlumberger, and are entitled to fewer holidays. Although

Malaysian and Indian TNCs may have a wage level as competitive as Chinese TNCs, they do not enjoy the great advantage of cheap and reliable supplies of equipment available in China.

Thirdly, CNPC has technology, human resources, equipment and efficiency level to provide a comprehensive service, covering oil exploration, refining and petrochemicals, and can therefore offer the foundation for sustainable development of the Sudanese oil industry. It was noted that, well before the Chinese entry, the Government of Sudan had a vision to 'build up the integrated Sudan Petroleum Industry and make the oil industry the engine of Sudan's economy' (CNPC, 2006). Such an integrated Sudan Petroleum Industry was envisaged to have upstream exploration as well as downstream petrochemical production for export via pipeline. CNPC was able to provide all the technology and equipment needed to realise this vision. Other TNCs in Sudan, including Petronas and ONGC, are able to provide most of the required technology and equipment, but it is questionable whether they would have provided the same technology and equipment at the same price and, more importantly, completed the projects within the same timeframe. CNPC has achieved several world records in the oil industry in terms of the speed of construction in Sudan. The company built a 15 million ton oil field in one and a half years. It also succeeded in establishing a pipeline totalling 1,500 kilometres in 11 months and took only two years to set up the Khartoum Refinery with a processing capacity of 2.5 million tons of crude oil. The Chinese and Sudanese interviewees who participated in the projects attributed such speed to China's centralised and integrated corporate system and the Chinese hardworking spirit. While Western TNCs tend to spin off non-core businesses and make strategic use of outsourcing, many Chinese TNCs still keep an integrated structure with hundreds of thousands of employees. CNPC had 1.67 million employees across all oil-related businesses in 2009. This structure, which is often viewed by organisational analysts as disadvantageous, turns out to be effective in mobilising all the capabilities to complete comprehensive oil projects in a short time period. One Sudanese manager in GNPOC compared CNPC with Petronas and ONGC. He concluded that efficiency is the major difference between the three companies and further elaborated that, while CNPC was very quick in decision-making, Petronas and ONGC would arrive at decisions 'slowly' and inevitably 'lost

many opportunities'. It was also revealed that the 1,500 kilometre pipeline project was initially contracted to an affiliate of Petronas, but had to allow a CNPC unit to take over after failing to meet the deadline set by the Government of Sudan.

Finally, CNPC as the largest state-owned oil firm in China considers itself to have an obligation to maintain good relationships with Sudan and also to protect 'China's image'. At the same time, it also enjoys strong support from the Government of China and its state-owned banks. Given these obligations and support, Chinese managers are able to consider their long-term strategy in developing relations with the host institutions. Counterparts from the West, and Petronas and ONGC, are more constrained by short-term considerations, including profit maximisation. For example, while CNPC could make a huge financial commitment to Sudan with government and bank support, Petronas and ONGC have less support from their respective governments and more constraints from their shareholders. Both companies are investing in several oilfields, but none of them could make funding, equipment, engineering and efficiency commitments to Sudan comparable to CNPC.

## **9.9 THE IMPACT OF FDI ON SUDAN'S INTERNATIONAL RELATIONS**

Chevron's decision to sell its concessions in Sudan was mainly related to the US policies towards Sudan. Insecurity, poor relations with the Government of Sudan and pressure from the US Government finally made Chevron decide to leave Sudan. The US Government also encouraged Chevron to leave Sudan by offering the company a tax write-off for its operations in Sudan, worth an estimated US\$ 550 million as a compensation for its losses there.

The Canadian oil company Arakis experienced financial problems in raising the funds needed to finance its investments in Sudan and this was also related to the US policies towards Sudan. Among other measures, the US Government, which had applied political and economic sanctions on Sudan in 1997, allegedly spread negative information concerning the Canadian company. This made it impossible for Arakis to continue operating in Sudan and it therefore sold its concessions in 1998.

Another Canadian oil company which faced pressures from the US Government to leave Sudan was Talisman. Talisman faced several problems related to its operations

in Sudan. The declared intentions to extend the US sanctions imposed on Sudan in 1997 to include those corporations borrowing from US capital markets, put the Canadian firm in jeopardy of losing a broad segment of its shareholder base and also the ability to raise funding in the US through its New York Stock Exchange listing. There was also pressure from the US Government to exclude the company from US capital markets. Talisman was attacked fiercely by human rights activists and other Non-Governmental Organisations who accused the company of being complicit in human rights abuses in Sudan. They lobbied the shareholders in order to force the company to leave Sudan. This campaign was not isolated from the US Government's influence. Human rights group and other lobbies in the US are selectively active with regard to human rights issues around the world. It is not a coincidence that they become actively involved in areas and issues that are only in accordance with US interests (Elbadawi, 2005). These factors, in which the US Government played a decisive role, led Talisman to leave Sudan.

In spite of the US aggressive policies, Sudan managed to develop and eventually start producing oil in 1999. This achievement was realised mainly through the investments made by Chinese and Malaysian oil companies since 1996. The Sudanese oil reserves were key to the eventual failure of the US sanction regime. Despite this regime, potential revenues were so great that, apart from Asian oil companies, European ones also invested. Countries subsequently resumed diplomatic relations with Sudan. These developments, among others, brought about a tactical change in the US approach towards Sudan. During this period several negotiation rounds were held between the Sudan People's Liberation Army (SPLA) and the Sudanese Government but with no results. The main peace initiative, which was supported by the US, was made by the Intergovernmental Authority on Development (IGAD) in 1994 and resulted in the IGAD Declaration of Principles. The IGAD is a regional grouping of seven African countries: Sudan, Ethiopia, Eritrea, Djibouti, Kenya, Somalia, and Uganda. It is clear that the initiative was a move made by the US through its regional allies. The Declaration of Principles for the first time addressed the right of self-determination for the south through a referendum.

The SPLA signed the Declaration of Principles but the Sudanese Government refused to sign it in 1994. It eventually accepted it in 1997 with no changes. The Declaration



of Principles became the basis of the negotiations between the Sudanese Government and the SPLA which led to the signing of the final agreement in 2005 on the basis of which the south has the right to self-determination through a referendum that held in 2011, and result in emerging of the new state in the south.

The US policy towards Sudan during this period was mainly based on a report published by the Centre for Strategic and International Studies. The report highlighted the changes that had occurred in Sudan during the last years and the need to change the US policies towards Sudan. It recommended that the Bush Administration concentrated its policy on the objective of ending Sudan's war on the basis of the IGAD Declaration of Principles. To do so, the Bush Administration should resume full diplomatic relations with Sudan and appoint a high level, fully empowered envoy. These recommendations were implemented by the Bush Administration who assigned Senator John Danforth as the president's envoy for peace in Sudan. The change in US policy towards Sudan was mainly related to the oil developments in Sudan. The US attempted to rein in China's growing influence in Sudan which had occurred because of the sanctions imposed on Sudan during the 1990s. Also, the significant oil discoveries made in Sudan by the Asian oil companies made US oil companies pressure the US Administration to change its policy so they could operate in Sudan and benefit from a lucrative oil industry with a promising future. The US's main objective, however, remained reaching an agreement that would end the Sudanese civil war and secure the separation of the south. Under pressure from the US, the Sudanese Government and the SPLA signed the Machacos protocol in July 2002. In October 2002, the US President signed the Sudan Peace Act, in which the US Administration threatens the Sudanese Government with punitive measures if it obstructs the negotiations, does not negotiate in good faith or if it is not in compliance with the terms of a permanent peace agreement. The Act also pledges US\$ 100 million of assistance for each of the years 2003, 2004, and 2005 to areas outside the Sudanese Government's control. The terms of a permanent peace agreement were set up by the US and the Act makes it clear that the US wanted the Sudanese Government to sign the agreement that the US wanted. In effect, that meant the agreement should guarantee the right of self-determination of the south which would pave the way for separation.

The US succeeded in forcing the Sudanese Government to sign the agreement in January 2005 on the basis of which the south has the right to self-determination through a referendum that will be held in 2011.

Oil is the main interest of China in Sudan and it has bolstered the Sudanese-Chinese relations, which started in 1959, substantially. The state-owned oil company, CNPC, which is China's arm in securing oil overseas, was granted its first concession in block 6 in 1995, but only started operating in Sudan in 1997 as a member of the GNPOC. Since then, the CNPC expanded its operations and acquired more concessions in Sudan. It holds a 40% interest in GNPOC, which owns the rights in blocks 1, 2 and 4 (Heglig and Unity fields), 92% interest in block 6, 41% interest in the Petrodar consortium which owns the rights of blocks 3 and 7, and has a 35% interest in block 15.

The Chinese company provided the Sudanese oil industry with the required investment to build the oil pipeline and consequently converted Sudan to an oil exporting country in 1999. Among the countries in which CNPC operates, Sudan is the most important. Even though Sudan's share of China's imports for 2004 was 4.7%, the importance of Sudan is in its share of the total oil imports from the wells owned by CNPC. Sudan accounted for 16 million of the 30.1 million tons of overseas oil the firm pumped during 2004. This share was increased due to the increasing oil production in Sudan and the expansion of the CNPC exploration and development operations in unexplored areas.

As a consequence, China has become the main trade partner of Sudan. In 2003, China was the destination of 24% of the Sudanese exports and the origin of 19.2% of the Sudanese imports. Also, China has expanded its economic activity in the country through banking, light and heavy industry, agriculture, fisheries and pharmaceuticals. The military cooperation between the two countries goes back to 1985, and has been further stimulated by the increasing Chinese interests in Sudan.

The Chinese role in developing the oil industry in Sudan has been substantial; it could be argued that, without the Chinese investments, Sudan would have remained unable to exploit its oil resources. Chinese involvement in Sudan was instrumental in the (partial) failure of the US sanction regime towards Sudan. Chinese involvement also

led to a change in the US approach towards Sudan. Through Chinese involvement it was proved that the Sudanese oil reserves were much more substantial than was expected. This subsequently made the US oil companies blame the US policies for depriving them of a lucrative oil market, and consequently put pressure on the US Administration to change its policies so US companies could also operate in the country. The Chinese increasing interests in Sudan and its control of the majority of the oil fields was perceived as a strategic threat to US interests in the region which also played a key role in the changing the US's approach towards Sudan. Thus, the FDI has its effect, Sudan benefits politically and wins a big change in US policies.

One of the main aspects of the US approach was to put the vast undiscovered areas of the south under its indirect control thereby preventing China from controlling more areas in the oil-rich south. The Chinese interests in Sudan were reflected clearly in the political support it provided to Sudan in the United Nations. The Chinese interests were the main factor in preventing the US from obtaining international resolutions that would have imposed economic sanctions, including arms and oil embargos on Sudan. The Chinese role in obstructing such resolutions was manifested in 1996 when the US was pushing for the adoption of a Security Council resolution that would have imposed economic sanctions, including an arms embargo. Due to the Chinese opposition, the resolution eventually imposed diplomatic sanctions only, which China did not implement. China also supported Sudan during the Darfur crisis and prevented the adoption of resolutions would have included any economic sanctions. In 2004, there was an attempt by the US to obtain such a resolution against Sudan which was vetoed by China.

China encouraged the Sudanese Government to reach peace agreements (as brokered by the US) with the south, as well as in Darfur, which evidently is not in the interest of Sudan as these threaten its unity. China is also participating in the United Nations Mission in Sudan, which was established in 2005 as a peace-keeping force to support the implementation of the peace agreement in the south. China is thereby attempting to create good relations with the south which is very important to China in order to protect its oil interests in the south in case of separation.

## **9.10 CONCLUSION**

The government encourages FDI to explore and produce the oil, many international firms have invested, and this has resulted in large revenues. Oil has had a catalysing impact on Sudan; it has had an impact on the development and also in Sudan's international relations. The main impact of oil internally has been paying for roads, bridges and hydropower dam projects that the country needs.

Oil also has an impact on international relations. Oil was one of the main interests of the US. The failure of the US policies to prevent FDI for the exploitation of the oil, and the increasing Chinese control of oil resources, led the US to change its approach towards Sudan after 2000.

The oil industry could be the key to the future of the economy of Sudan. Although the country is considered to be vastly under-explored, it has been a producer of oil and gas for a number of years. The country's oil and gas reserves are vast. The downstream oil industry in Sudan is an important sector in country's economy as Sudan has two refineries.

## **Chapter 10**

# **INFLOWS OF FOREIGN DIRECT INVESTMENT TO REAL ESTATE IN SUDAN**

### **10.1 INTRODUCTION**

Sudan's economy is booming on the back of increases in oil production and large inflows of FDI. In the frame of the continuous growth in real value of the domestic product and implementation of macroeconomic reforms, signs of prosperity have pervaded the community and encouraged many foreign investments to enter into the Sudanese market. This environment attracted many investors to the telecommunications, oil production and real estate sectors.

This chapter includes analysis to the governmental policies affecting FDI in the real estate sector in Sudan. In this chapter, the researcher illustrates the findings of field research and a full survey of the real estate investment in Khartoum. The outcome shows that FDI plays an active role in the real estate and construction sectors which make an important contribution to GDP in Sudan.

### **10.2 GOVERNMENTAL POLICIES IN THE REAL ESTATE SECTOR**

The Ministry of Investment implements investment government policy and a legal and institutional framework which supports an investment climate apt to attract FDI. The Ministry of Investment is a member of the World Association of Investment Promotion Agencies. Foreign investment in Sudan is protected by binding international instruments. Sudan is a member of the World Bank's (MIGA), and the International Centre for the Settlement of Investment Disputes. World Bank Guidelines are used by foreign investment promotion agencies, including the Sudanese agency. It is expected that the International Finance Corporation, the private sector investment arm of the World Bank Group, whose mission is to promote sustainable private sector investment in developing countries in coordination with Foreign Investment Advisory Services, will act within the remit of its mission, insofar as Sudan is an emerging economy, having considerable investment potential.

In line with United Nations Conference on Trade and Investment's (UNCTAD) declared policy, it is also envisaged that domestic policies and international action would be mutually supportive in bringing about investment inflows. Sudan is also a member of the African Development Bank, the Islamic Development Bank, the Inter-Arab Investment Guarantee, and the Agreement on Promotion and Guarantee of Investment.

The Sudanese Government's general policy maintains and constantly declares that FDI has a constructive effect on a country's economy in terms of added technological, managerial and financial wealth. An active openness to technology, marketing channels, organisational and managerial expertise adds to domestic savings, investment and eventually secures an effective utilisation of economic resources. Higher levels of investment and productivity are key elements to stimulating growth in Sudan as a developing country.

Attracting investment is a competitive exercise which requires stable and sound macroeconomic policies where the risks in the environment are low. Stable, transparent and predictable open investment policies lend confidence to take the risk inherent in investing capital. The said general policy submits that political and social disturbances, currency risk, financial risk and government regulations are the most serious risks that inhibit investment decisions. Again, private sector investment depends on an investment climate characterised by a good legal framework maintained by constitutional guarantees against expropriation. Similarly, a favourable investment climate requires good governance in connection with the quality of business regulations, sustained by institutions competent to implement them.

The Ministry of Investment, supported by other governmental bodies, restructured the general policy for the encouragement of investment in light of the objectives as contained in the Encouragement of Investment Act, 1999. It also determines the priorities in granting the licenses and facilities. It is also responsible for issuing all the requisite directions, regulations and orders conducive to ensuring a proper implementation of the Act. The Ministry of Investment undertakes the task of overall supervision of investment activities in Sudan. One aspect of the Encouragement of Investment Act is that it provides the Ministry of Investment with flexibility,

sufficient to exercise a proper discretion within the ambit of well-defined guidelines, capable of catering for any envisaged misuse. Accordingly, bureaucratic screening has been removed by entrusting administration of the law to one ministry in coordination with other related ministries and governmental agencies. The Ministry of Investment is accountable to the President. A specialised body in the Ministry of Investment is assigned the job of preparing feasibility studies for proposed investment projects, in addition to attracting FDI.

As regards insurance against non-commercial risks, Sudan is a signatory to the World Bank's MIGA convention. The Convention provides coverage against non-commercial risks such as transfer restrictions, breach of contract, war and civil disobedience. Investors under the Sudanese investment legal regime are exempted from payment of business profits tax for a period of ten years for strategic projects, and five years for non-strategic projects, calculated from the date of commencement of production. This exemption may be extended for a further period as the Minister of Investment deems fit. Again, there is an automatic exemption from payment of customs duties, surcharges and any other similar duties relating to imported machinery, equipment or apparatus necessary for production. The exemption covers all imported goods used by the investor's project. In connection with export, the exemption covers relief from export tax and duties in respect of project's products, including production charges and any other similar duties. Capital allowances are granted to investors who own depreciable assets and use the assets in the production of income. Depreciation allowance is calculated during the year of complete tax exemption on the basis of replacement value. Depreciable assets are grouped in classes, and the applicable allowance rates prescribed under the regulations are applied. Any loss incurred during the period of complete or partial exemption, is to be considered as if incurred during the last year of such a period. The expenses incurred before production begins, and depreciation deductions arising within the period of exemption, are deemed to be a loss liable to be deducted from profit.

In connection with investment legal forms, in practice there are no administrative restrictions on foreign investment in Sudan. International companies may open locations in Sudan under a range of legal forms governed by the investor's strategies, plans and the degree of freedom that Sudanese operations are authorised by the parent

company. Each option implies a specific obligation with regard to company law. A potential investor may form a strategic alliance with an already existing Sudanese company on the basis of mere contractual arrangements. A foreign entrepreneur may start as a sole proprietor having a business name. A foreign company may establish an entity in the form of a branch or a subsidiary with an independent existence from its parent company. An investor may elect to set up a joint venture in the form of a partnership or a limited liability company which is the form most often chosen by investors. Companies which elect to scout for business in Sudan before embarking on a project may decide upon a short-term solution by allocating a liaison office which does not engage in commercial activities, or a sales representative whose mission is to take orders and put them forward to his or her company.

### **10.3 INFLOWS OF FDI TO THE REAL ESTATE SECTOR**

Sudan's economy is booming on the back of increases in oil production, high oil prices, and large inflows of FDI. These are the main reasons for significant development in different sectors; oil production, telecommunications, transportation, and real estate. GDP growth registered more than 10% per year in 2006 and 2007. From 1997 to date, Sudan has been working with the IMF to implement macroeconomic reforms, including a managed float of the exchange rate. Sudan began exporting crude oil in the last quarter of 1999. Agricultural production remains important, because it employs 80% of the workforce and contributes a third of GDP.

The private sector plays an active role in the real estate and construction sectors which contributed US\$ 65 million to GDP, representing a growth rate of 3.5%. This sector is supervised by the ministries of engineering affairs in Sudan's different states, as they issue the necessary permits and licenses for operating in this sector. Renting an apartment costs US\$ 5,000 per month for normal apartments to US\$ 20,000 per month for first class luxury apartments. Two storey houses vary in rent from US\$ 20,000 per month to US\$ 60,000 per month. As for renting an office in the centre of Khartoum, the costs range from US\$ 15 to US\$ 20 per square metre. This sector is considered very promising to investors.

In this chapter, the researcher will focus on the development in the real estate sector. The researcher in this study is targeting the development in the real estate sector and



the study is based on direct investigation, research and related written materials, including: Market research via random sampling, direct contacts, telephone communication, web literature and governmental information in respect of real estate.

### **10.3.1 Investment Environment of the Real Estate Sector**

Real estate in Sudan is one of the major revenue generating sectors; the growth and the depreciation of this sector influences the economy. Owning a property in Sudan is one of the greatest assets and is one of the most profitable investments. There is less chance of a loss as the real estate growth graph is escalating day by day.

Sudanese real estate is witnessing a boom and the scenario keeps evolving with every passing day. It is estimated that Sudanese real estate is presently growing at 22% per annum and the property industry boasts a wide range of products that includes property prices which would suit even people in a low income group. The Sudanese real estate industry is expected to grow beyond US\$ 50 billion in the near future.

A key point to note is that the Sudanese real estate is mostly privately owned, and is a highly unregulated, disorganised market with huge potential. But after witnessing strong growth and a start of FDI inflows, the real estate sector is slowly evolving into a more organised one. Real estate is certainly zooming away in the wake of the current scenario, riding on the high growth wave. A number of non-real estate companies are entering the sector to leverage the opportunities. Sudanese real estate is a growing sector for both investors and people who are looking for a home. The real estate sector is making rapid strides on the back of country's surging economy.

After a slow start, FDI in Sudanese real estate sector is poised for rapid investments, with over US\$ 3.5 billion likely in the near future. The attraction of real estate is now in no doubt after an international investor pledged to put millions of dollars into the Sudanese real estate sector. From consultants to financiers to developers and construction companies, the real estate sector is witnessing a huge change in terms of operations.

There are many factors responsible for the rapid growth of real estate in Sudan. The steady expansion of the IT and telecommunication sectors in Sudan have played a

major role in the development of the real estate sector. The constant expansion of the IT sectors; MNC and corporate firms have paved the way for the growth of the real estate sector particularly in the commercial sector. Apparently all these factors have also provided better employment opportunities to the people of Sudan.

The adoption of an FDI policy is another factor responsible for the growth of real estate sector. As mentioned earlier, the FDI policy has resulted in the arrival of foreign investors in the Sudanese real estate market. The initiation of the foreign investors will lead to an efficient management and use of more advanced technology.

The current Encouragement of Investment Act targets the encouragement of investment into real estate projects in Sudan, as it may achieve the objectives of the development policy, and the investment initiatives, on the part of the Sudanese and non-Sudanese private sector, the cooperative, mixed and public sector. No discrimination may be made between invested money, by reason of its being local, Arab or alien, or by reason of its being public, private, cooperative or mixed sector.

No privileges, as may have been granted to any of the investment projects in accordance with such conditions and safeguards, may be affected. The strategic projects, such as a real estate investment, specified in the regulations, shall after its registration, in accordance with the laws that govern the real estate sector, enjoy exemption from the business profits tax for a period of five years, the effect of which shall commence as of the date of commercial production, or practice of activity. Each strategic and non-strategic project, as may be specified in the regulations, after registration thereof, in accordance with the laws organising the same, shall enjoy such customs privileges, as the Council of Ministers may prescribe.

The Minister of Investment, upon the approval of the Minister of Finance, and in consultation with the Competent Minister may grant preference privileges to such projects, as may satisfy any of the following features: (a) Direct investment towards the least developed areas; (b) Assistance in the development of export capabilities of the country; (c) Contribution towards the achievement of integrated rural development; (d) Creation of significant chances of work; (e) Working to encourage charitable trust; (f) Working to develop scientific and technological research, and (g) Re-investing the profits thereof.

Other factors responsible for the rapid growth of real estate in Sudan are easy access to the bank loans which has resulted in easy property investment. There are various national and multinational banks in Sudan which offer easy property loans; naturally this makes it easy for the property buyers even from the middle-class society.

The growth of the Sudanese economy is one of the fastest all over the world. This factor directly influences the real estate sector. Major cities like Khartoum, Omdurman and other cities are affected by the growth of the Sudanese economy.

### **10.3.2 Investment Guarantees to Real Estate Sector**

An investor enjoys the following guarantees:

- The non-nationalisation, or non-confiscation of his project, non-acquisition of all, or part of the estates of the project thereof, or his investments, for public interest, save by law and with consideration of just compensation.
- The non-attachment, non-confiscation, non-custody or non-sequestration of the property of his project.
- The re-remission of the invested money, in case of the non-execution of the project, at the outset, liquidation, or disposal of the same, in any of the ways of disposal totally, or partially, in the currency in which it has been imported; on condition of satisfying all the obligations legally due thereon, and in the case of non-execution of the project, at the outset, machinery, equipment, apparatuses, means of conveyance and other requisites, which have been imported for the project, may be re-exported, whenever all the obligations mentioned in this paragraph have been satisfied.
- The remission of the profits and the cost of financing for the foreign capital, or loans, in the currency in which the capital or loan has been imported, at the date of accrual, after payment of the obligations legally due on the project.
- The import of such raw materials, as the project may need, and the export of the products thereof, after the automatic registering, of the investment project, onto the Exporters and Importers Register.

#### **10.4 GOVERNMENTAL FACILITIES FOR INVESTORS IN REAL ESTATE**

Generally, real estate investment is encouraged by the government of Khartoum State and considered as a strategic investment; it will therefore find full support, especially if the Ministry of Physical Planning and Public Utilities enters as a shareholder in the business. Most investors benefit from governmental participation due to the fact that the real estate sector is one of the main governmental plans for revitalisation.

Many factors stand behind the entry of FDI into the market, some of which are: (a) the increasing demand for real estate from the private sector, especially foreign companies and investors, make it more attractive to enter the market; (b) the policies of the Central Bank of Sudan means banks other than the Sudanese Real Estate Bank were not permitted to finance investments or construction projects until 2001; (c) the economic stability that Sudan experienced during the last ten years made investing in real estate less risky, and (d) oil production as oil started to be produced on a large scale in 1997, meaning the government started to build modern oil infrastructure according to international standards and this construction movement resulted in higher demand. Many foreign companies invested in oil production. The needs of these companies to build, buy, and rent created new demand in the real estate market for residential and office space. The private sector was encouraged to enter the market because of high demand and the feasibility of investing in real estate.

Until recently, most buildings, especially residential buildings, were single storey buildings. Costs associated with horizontal expansion (i.e., infrastructure) called for vertical expansion in buildings, changing the cities' profiles. Therefore the demand for multi-storey buildings has increased significantly in the last ten years. Many new projects are under construction, and some are subject to the approval of the governmental authorities.

According to experts, the real estate sector will be able to consume the fruits of the government policies, in terms of boosting development of new properties. The government policies are also expected to benefit the real estate sector in the country, thus, the real estate is poised for a boom, taking the rest of the economy with it.

#### **10.4.1 Components of Real Estate Projects**

- Land: according to the current investment encouragement law, land is offered either free or for nominal prices and, due to the high level of land prices in some parts of Khartoum, this is the first advantage for foreign and domestic investment; moreover, revitalised land is much lower in price, below all expectations.
- Residential areas: in recent years, after the expansion of the oil export market and upgrading of lifestyles, people have begun to think of quality buildings. This encouraged the investors to diversify from horizontal building structures to vertical in order to acquire lower cost space and satisfy the increasing demand either for rent or exit investments. Investors were unable to go for one-off large investments, restricted by the demand shortage of finance. In the year 2011, the Bank of Sudan launched a new policy to encourage customers to buy and acquire houses and apartments. The bank will directly buy the required domiciles and sell them for consumers by deferred payment; this policy helps both investors to adopt exit investment policies and also customers who are eager to own their own private residence. Also, this policy will satisfy small scale investors who work in the rental business.
- Business towers: almost all investors in Sudan have central offices or agents in Khartoum. The excessive growth of Arab investment in Sudan requires unique buildings to match the image of their parent companies. A survey conducted at the beginning of this year revealed that residential areas, such as Amarat, Taïf and Riyadh which become business areas lack the facilities for such a purpose. Investing in business towers attract these premises to shift to more convenient buildings when all business facilities will be available. In addition, business compound towers ease the need of respondents who seek related business facilities in one area to eliminate time and transport constraints.
- Commercial centre: the establishment of the Afra shopping centre mall by a Turkish company witnessed a significant response, being the first mall to be established in Khartoum. Although the mall is considered of small size when compared with large malls in Kuwait and its neighbours, it is the first

shopping investment in Sudan. People come from Omdurman and Khartoum for the shopping in this mall; the success of which has encouraged the owners to establish other malls in each town. Malls are now considered as an attractive means for people to spend their leisure time and benefit from the different activities.

- Recreational area: three foreign companies from Kuwait and Egypt are working to establish a recreational area in Khartoum. The natural diversity of Sudan allows for the existence of all kinds of animals that may be needed to establish an attractive zoo. Past experience showed that Khartoum Zoo was the main source of leisure time spending, not only in the holidays but continuously, before its closure. Similarly, the water front comprising the river Nile and its two feeding streams are appropriate for marina developments. Golf course investment is a leading activity in the whole of Sudan. Demand is very high because golf is associated with the upper class of society and the expansion of this in recent years has led to the expansion of demand for sports such as golf and shooting clubs. So the potential success of this business was driven by foreign companies.

## **10.5 FIELD RESEARCH FOR THE REAL ESTATE SECTOR**

Despite the international financial crisis, the Sudanese real estate market in the capital, Khartoum, is booming. Many local and foreign companies from UAE, Qatar and Malaysia are investing in the real estate, attracted by a boom fuelled by rising oil production and the signing of the Comprehensive Peace Agreement in 2005 between Khartoum and former rebels in southern Sudan. The skyline of the Sudanese capital Khartoum has noticeably changed in the last few years. Small buildings are disappearing and new high-rises are being built in their place.

Khartoum is becoming a huge construction site. High-rise buildings are under construction in Khartoum, Khartoum North and Omdurman, the three districts that make up the capital. The buildings, which reach 15 stories high, are being built in areas of the city that are close to the main business districts and where local services are good. And the designs can be dramatic. The al-Fateh Tower is one such building

which would not look out of place in Dubai. But the trend is spreading to other parts of Khartoum.

The owner of one of the high-rise buildings says that he not only wants to earn a living from renting out flats in the block but also plans to provide his family and his children somewhere to live. He hopes to make enough money to invest in new projects in the future.

### **10.5.1 Hotels Sector**

Sudan is one of the largest Arab nations. It is rich in history dating back to the Ancient Egyptians and the Ancient Nubians. There are many pyramids all over Sudan, attracting many tourists from Syria, Egypt, Morocco, Jordan and other Arab countries. They also attract tourists from Western nations. Sudan was voted the 8th most popular Arab nation to visit by the Council of Arab Economic Unity. Sudan also has many modern hotels including the five stars hotels in Khartoum. The government of Sudan also pledges US\$1 billion a year to increase the Tourist Industry.

One of the effects of FDI in the real estate sector is that the capital of the country has changed. Khartoum has one of the largest open markets, the Al Arabi Shopping Centre. The market is spread over several blocks in the center of Khartoum, just south of the Great Mosque and the minibus station. It is divided into separate sections, including one focused entirely on gold. Al Qasr Street and Al Jamhoriyah Street are considered the most famous high streets in Khartoum State. In 2010, Sudan's first medium scale shopping mall opened, located in the southern suburb of Khartoum. The Turkish Mall has a supermarket, retail outlets, coffee shops, a bowling alley, movie theaters, and a children's playground. In 2011, Sudan opened the Hotel Section and part of the food court of the new, Libyan Cornithia Hotel Tower, and the Mall/shopping section.

A field survey found that foreign direct investors in the real estate sector favoured Chinese cities with more international tourists and more foreign investments. It is because both international tourists and foreign managers in foreign companies prefer to stay in hotels or apartments that provide offices (or easy access to them), accommodation, and eating facilities, meeting Western standards. Results reveal that

the higher level of FDI inflows to the host country will lead to greater amount of FDI to the real estate sector.

The investment law in Sudan encourages many businesses into the real estate sector. For example, the numbers of hotels built by foreign investors are increasing; in Khartoum there are 46 hotels, five of them are five star hotels; three are four star hotels; 14 are three star hotels; seven are two star hotels, and the rest are one star. Tables 10.1 to 10.5 show the details of these hotels and Table 10.6 shows the towers.

**Table 10.1: Five Star Hotels in Khartoum**

<b>Hotel</b>	<b>Flats</b>	<b>Rooms</b>	<b>Beds</b>
Hilton	9	270	
Grand Holiday Villa	2	140	280
Friendship Palace	11	134	268
Salaam Rotana	4	236	480
El Faith Tower	19	230	460

*Source:* Researcher Field Survey

These hotels reported in Table 10.1 are FDI from different countries, from Europe, Malaysia, China, United Arab Emirates and Libya. And hotels reported in Table 10.2 are FDI from Europe, Bahrain and Qatar.

**Table 10.2: Four Star Hotels in Khartoum**

<b>Hotel</b>	<b>Flats</b>	<b>Rooms</b>	<b>Beds</b>
Meridian	9	110	220
Bahrain	9	58	116
Firdows	9	56	112

*Source:* Researcher Field Survey

**Table 10.3: Three Star Hotels in Khartoum**

<b>Hotel</b>	<b>Flats</b>	<b>Rooms</b>	<b>Beds</b>
Enaam	6	40	75
Shahrazad	7	65	111
Khartoum Plaza	8	58	94
El Feisal	7	40	80
Sahara	3	49	73



<b>Hotel</b>	<b>Flats</b>	<b>Rooms</b>	<b>Beds</b>
Dubai	7	40	80
Oasis	5	31	62
Sharja	6	35	60
Sindian	11	27	45
Dandas	2	40	80
Horizon	2	54	108
Taka House	3	42	79
Qubaa	7	54	90
Safari Place	11	65	107

*Source:* Researcher Field Survey

The field survey for hotel sector in Khartoum shows that FDI from Gulf, Egypt, Kenya, Qatar, India and UAE invest in three and two stars hotels. Most of the three and two stars hotels are preferred for some personnel working for foreign companies and need to stay for long period.

**Table 10.4: Two Star Hotels in Khartoum**

<b>Hotel</b>	<b>Flat</b>	<b>Rooms</b>	<b>Beds</b>
5m	5	32	48
Dama	3	32	64
Acropolis	2	38	63
Falcon	3	18	24
Central	3	45	75
Badr Tourist	3	40	69
Green Village	1	90	174

*Source:* Researcher Field Survey

**Table 10.5: One Star Hotels in Khartoum**

<b>Hotel</b>	<b>Flat</b>	<b>Rooms</b>	<b>Beds</b>
17	57	368	631

*Source:* Researcher Field Survey

### **10.5.2 Business Towers Residential Investment**

Khartoum is becoming a huge construction site. High-rise buildings were constructed in Khartoum, and the trend is spreading to other parts of Khartoum state. The foreign companies provide a variety of properties, luxurious residential including villas and

apartments. There might be an increase in demand and increase in investor confidence, coupled with increased transparency in the retail real estate sector due to FDI. With competition increasing, everyone is of the view that it will increase the interest and confidence level of real estate developers to set up quality shopping centres. They now have reason to consider investing in real estate sector with a clear vision to long term profit. Table 10.6 shows major investment in business towers.

**Table 10.6: Business Towers in Khartoum**

<b>Building</b>	<b>No. of towers</b>	<b>No. of storeys</b>
AAAIID Tower	2	10
Sudanese Kuwaiti	5	6
Acolid Tower	1	10
Baraka Bank	3	9
Social Insurance Tower	4	10
Tadamon Bank Tower	2	9

*Source:* Researcher Field Survey

Communal residential buildings were first introduced in 1975 but the investment has continued recently and ramped up. Major investments are shown in Table 10.7.

**Table 10.7: Residential Towers in Khartoum**

<b>Investor</b>	<b>No. of towers</b>	<b>No. of floors</b>
Real Estate Bank	11	6
Al Nasr	20	4-8
Al Higaz	4	11
Al Yasamine	2	7
Al Nelein	10	9

The Nelein Towers project is located south of Khartoum hospital, east of Almasalmiya Bridge facing the Gum Arabic and civil defence headquarters. The project comprises ten towers, each with nine storeys; each apartment has two rooms, hall, saloon, kitchen and two bathrooms. Payment will be made via instalments over five years.

The current investment in residential type may be considered as duplex buildings and modern type villas. The locations are close to the city in the outskirts of Khartoum and Khartoum north; the major investments are Saria residence, Arak residence,

Yasmine residence, Napta residence, and under construction, the projects of Dyar (Qatar) and Alnnor (Kuwait).

All these investments, and others classified as medium to high end, are driven by foreign investment.

## **10.6 REAL ESTATE MARKET SURVEY IN KHARTOUM**

Bank loans and savings from years of work abroad, especially in the Gulf States, are now being ploughed into privately-owned building projects. A one bedroom flat in the new developments costs about US\$ 120,000 (£72,500), while the cost per square metre of a plot of land in a good location could reach more than US\$ 1000 these prices are reported in Table 10.8 and Table 10.9.

Many of the buyers are very rich people, expatriates living and working abroad, or locals who sold their old houses which were located in desirable neighbourhoods in order to downsize to smaller but more luxurious and modern properties. Now, many Sudanese companies are joining in, as are foreign investors from the Gulf States and South East Asia.

The field survey is focusing on the real estate market in Khartoum, the Awab agency was consulted for real estate services: Greater Khartoum is the zone that attracts investors and tenants who seek a quiet residence, especially in the Street 15 area because of its strategic site neighbouring the services and business centres. As for the commercial aspect, the 'SAGANA' area is the one in most demand by companies and commercial offices.

High demand is attributed to the availability of residential and commercial compounds supplied by electricity, communications, and sewerage and water services. The rise in sale prices and rental prices reflects the openness of Sudan to external world compared with the past.

The Safaa real estate agency was also consulted for real estate in Khartoum. The owner declared that there are factors in the real estate market which have caused price variations, resulting in the escalation of prices for strategic sites by 20-25%. The transition of Khartoum into a finance market for East Asian and African countries has

benefited sellers and buyers, although sometimes a shortage of liquidity intervenes. The prices of rents of popular houses have no effect on the general rent prices because the rental prices depend on the owners of the real estate requesting down payments for around one to two years.

The owner of the Amarat Abu Alsoud agency commented that the areas that were witnessing increasing real estate demand were Amarat, Arkawait, Taif and Azehor. The increase in foreign organisations and foreigners has increased the demand for rental services. The increased demand for villas and residential housing in the new cities is identical to Sabaa and others because they adopt commercial ownership.

The Khartoum North Nooraldeen real estate agency said that rental prices differ; highest in Khartoum State followed by Khartoum and then Omdurman.

The owner of an Omdurman real estate agency revealed that the price per square metre in the Omdurman real estate market was continuously increasing. Riyadh, the sole agent for the Palm and Arabic gulf housing project, commented that 80% of the Palm Residential was bought by Sudanese expatriates in the Kingdom of Saudi Arabia and that the internet had made it easy to sell off plan.

Table 10.8 shows the increasing prices of real estate during the period 2003-2007 from the real estate market survey in Khartoum State. The high demand for properties results in significant increase in the price of properties for rent or sale. The increase of the price encouraged many individuals and companies to invest the real estate sector and construction market.

**Table 10.8: Price Comparison**

Real Estate	Description	Price 2003	Price 2007	Utility
Apartment Price in US\$	2 rooms 200 m <sup>2</sup>	60,000	120,000	Sale
House Price in US\$	950 m <sup>2</sup> 3 rooms & Saloon	1,300,000	2,000,000	Sale

*Source:* Researcher Field Survey

Prices were reasonable at the year 2003 and show high increasing at the year 2007 in relation to the increasing of FDI inflows and the high demand for the properties. Prices can be irregular depending on the owners' behaviour; Tables 10.9 to 10.12 below illustrate the different pricing of different types of real estate.

**Table 10.9: Price of Real Estate from Different Agencies**

Agency	Real Estate	Description	Price 2008	Location	Utility
Awab	House	Room + hall	US\$ 7,500	Khartoum	Rent
		Normal site	US\$ 5,000	Centre	Rent
		Distinctive site	US\$ ,1750	Gebrah-18	Rent
Abu-Alsoud	House	200m <sup>2</sup> 3 rooms	US\$ 1,900	Omdurman	Rent
	House	4 rooms + hall	US\$ 2,500 p/m	Khartoum	Rent
	Apartment	2 rooms + hall	US\$ 500 p/m	Lamab	Rent
Qutuf	Duplex	3 rooms + saloon	US\$ 360,000	Kalakla	Rent
	House	Normal	US\$ 2,000 p/m	Arkwait	Rent
	Apartment	Normal	US\$ 1,000 p/m	Mughtarbeen	Rent

*Source:* Researcher Field Survey

Gulf companies entered the real estate market with a new and ambitious strategy, providing properties that are of superior quality, financed, finished, serviced, managed and integrated. The towers are self-contained development featuring a wide range of facilities including a business centre, park, mall spa sports and leisure facilities. Table 10.10 reports residential towers built by Gulf companies and shows the prices.

**Table 10.10: Residential Towers in Khartoum**

Tower	Location	Storeys	Apartments	Area	Price	Utility
Safa	Khartoum near airport	7 + g floor	3 in each flat	150m <sup>2</sup> - 200m <sup>2</sup>	US\$ 1,500/m <sup>2</sup>	Possession

<b>Tower</b>	<b>Location</b>	<b>Storeys</b>	<b>Apartments</b>	<b>Area</b>	<b>Price</b>	<b>Utility</b>
Higaz	Riyadh	9 + g floor	3 in each flat	100m <sup>2</sup>	US\$ 1,000/m <sup>2</sup>	Possession
Yasmine	Riyadh	6 + g floor	4 in each flat	130 <sup>2</sup> – 200m <sup>2</sup>	US\$ 1,000/m <sup>2</sup>	Possession
Alnasr	Khartoum West Afra Mall	8 storeys – 10 towers	4 in each flat	100m <sup>2</sup>	US\$ 1,000/m <sup>2</sup>	Possession
Alahlam	Khartoum	7 + g floor  6 towers	7 in each flat	130 <sup>2</sup> – 200m <sup>2</sup>	US\$ 1,000/m <sup>2</sup>	Possession

*Source:* Researcher Field Survey

### **10.6.2 Real Estate Large Projects**

At the confluence of the river Nile, work is underway on a new project: the Almogran business city. Almogran, which means confluence in Arabic, is being marketed as the new business district of Khartoum and many companies have already bought plots of land to build their headquarters there. It includes a business quarter, a recreational area with an 18-hole golf course and a residential area with 7,900 luxury apartments and 1,100 villas, all on the banks of the White Nile. Al-Sunut Development Company spent US\$ 2.5bn on building the infrastructure for the business and residential areas. But other contractors from Malaysia, UAE and Sudan are all contributing to the project.

This is not the only major project in Khartoum. A new development by Qatari businessmen in Khartoum established North on the banks of the Blue Nile. The project also combines business and residential districts including five star hotels and shopping centres.

One of the biggest projects in the real estate development sector in Sudan is the Alnnor City of the Grand Kuwait Company. The project has a total area of 17 million square metres, and is an integrated city comprising all health, education, housing, commercial, recreational and contemporary infrastructure services. The city is aligned

to a modern architectural design.

Al-Noor City has a distinctive city site close to the centre of Khartoum and its outskirts are near Khartoum's new international airport and near the Omdurman centre. The city assimilated the nearest area to Khartoum's new international airport which helps with integrating hotels and luxury services in addition to logistics services.

The project promoter's strong financial status leads to the proper execution of contracts and the maintenance of a timely schedule of implementation. The distinctive geographical location for the city, overlooking the White Nile ring roads network, connects the project with other cities in the state. It is more advanced in structure than any project carried out by local companies. Sudan's architectural transitional stage facilitates the project's marketing activity.

Income per capita during the second millennium, associated with peace and petroleum exploration, increased and approached US\$ 1,000, facilitating more opportunities for developers. Likewise, migration between Sudan and European countries stimulates demand for advanced residential development. The scarcity of residential lands close to metropolitan areas has increased demand on real estate in the cities.

The oil-powered boom in building will be good for the Sudanese economy. Oil production will make the Sudanese economy, which is over-dependent on agriculture and natural resources, more diverse. The country is one of the fastest growing in Africa, according to the IMF, and Khartoum, which is home to most of the businesses in the country is benefitting even more. As a result, the capital's skyline is changing for good.

## **10.7 DISCUSSION OF THE REAL ESTATE SECTOR**

Few studies have been carried out to highlight the history of real estate in Sudan; only one comprehensive report exists, carried out by the Ministry of Works in collaboration with Department of Statistics in 1991. This report concentrated on the housing sector only. The report followed the most common method of deriving statistical demand curves, which used the time series data for prices, sales and other

relevant variables. It plotted all of the price sales on a chart where price is measured vertically and the quantity sold is measured horizontally.

The intersection point yielded the projected demand for housing. In regions other than Khartoum, the demand was realistic because the cost of land was attainable and the supply was very high. In rural areas, sale of land was infrequent and people relied on areas owned traditionally by families. In urban areas, land is distributed to eligible individuals via periodic housing plans and demand is usually met at a reasonable rate. In practice, the demand curve usually shifts a good deal over the period for which statisticians have price and sales data. Although the same criteria of projecting housing plans was carried out for in 1961/1970, 1977/1983, 1983/1990 and 1991, demand is still high.

The demand in Khartoum State is considered as a latent demand where customers are not able to obtain their own residence and head for residential rental. The primary hindering factor is finance for real estate, as finance is in an equally difficult situation. Even the term 'real estate finance' is sometimes translated as 'real estate subsidies'. More fundamentally, effective legal bases do exist for private land ownership, bankruptcy, foreclosure, or eviction, placing the advantage with any lending activity. At that same time, there was only minimal experience with any form of financial intermediation (the newly developing banks notwithstanding).

The report provided a framework for analysing the Sudanese real estate sector during the economy's transition to liberalisation, discussed the results that had been achieved, and offered suggestions for improving the situation. It developed the framework and identified the factors that were holding back the transition of the real estate sector to a market system. It also developed policy proposals for accelerating the transition to a market system, stimulated real estate production, and creating a real estate sector.

The factors that govern real estate demand are the effects of foreign investors, the population, the rate of growth, birth and mortality rates, the gender ratio, and the employment rate. Table 10.11 below illustrates the historical factors.



**Table 10.11: Population Data in Selected Sudanese States, 2003**

<b>State</b>	<b>Estimated population (000)</b>	<b>Growth rate (%)</b>	<b>Population over 24 years (%)</b>	<b>Urban population (%)</b>	<b>Gender ratio: males per 100 females</b>
Sudan	33,648	2.63	39.45	35.52	101.53
Northern	614	1.75	44.58	15.68	95.66
Nahr Alneel	954	1.95	42.37	34.87	98.30
Red Sea	732	0.52	45.81	61.80	117.25
Kassala	1,584	2.51	40.06	35.59	96.98
Khartoum	5,352	4.04	45.42	86.90	111.78
Aljazeera	3,692	3.00	40.22	23.11	98.65
Blue Nile	696	3.01	38.50	25.70	108.46
West Kurdfan	1,183	1.7	35.45	22.29	95.29
North Darfur	1,603	3.23	35.62	19.99	96.26
Upper Nile	1,494	0.93	39.25	26.01	100.97
Bahr Elgasal	2,491	2.36	40.15	13.52	104.03
Equatorial	1,300	1.01	41.37	27.28	109.99

*Source:* Researcher Field Survey

The researcher selected the above States to represent all Sudan; the most important indicator is that Khartoum State has the highest rate of annual growth and highest rate of urban population.

The dramatic change in demand for real estate is derived from the demand of services from or to the external markets, as well as lack of relations between the states. Following this, real estate demand is fully dependent on the growth of services,

whether rendered domestically or imported. The factor that governs this growth is the pattern of investment and the increasing standards of living.

The increasing productivity is the base for sustained logistics creation and rising standards of development. To ascertain the role of logistics in leading real estate market expansion in Sudan, a precise overview of the economy, especially for the past three years will be required as to how the market is expanding and how the need for newcomers coincides with the rapid growth of the economy. The outcome shows that FDI plays an active role in the real estate and construction sectors, which have important contribution to GDP in Sudan.

## **10.8 CONCLUSION**

The real estate sector is a critical sector of Sudan economy. It has a huge multiplier effect on the economy and therefore, is a big driver of economic growth. It is the second-largest employment-generating sector after agriculture. Growing at a rate of about 10% per annum and this sector has been contributing about 20-22% to Sudan's GDP. Not only does it generate a high level of direct employment, but it also stimulates the demand in over some industries such as oil, cement, steel, paint, brick, building materials, consumer durables and so on.

The government's policy to allow FDI in this sector led to a boom in investment and developmental activities. The sector not only witnessed the entry of many new domestic realty players but also the arrival of many foreign real estate investment companies including private equity funds, pension funds and development companies entered the sector lured by the high returns on investments. The real estate sector has been riding through many highs and lows since then. The industry achieved new heights during 2007 and early 2008, with growth rate 6.5% and 7.2% respectively. These years characterised by a growth in demand, substantial development and increased foreign investments.

The growth rate of the real estate sector increased from 4.4% by the end of 2009 to 5.5% by the end of 2010, along with the rate of growth of the building and constructions sector remaining constant at 10.2%. The share of the real estate sector to the GDP increased from 22.7% in 2009 to 22.9% in 2010. In the years 2007, 2008,

2009 and 2010, the housing and real estate sector attracted FDIs of 8%, 9%, 10.3% and 11% respectively, of the total FDI in Sudan.

The focus on ‘affordable housing’ helped the sector tide over the financial crunch it had witnessed. There is no doubt that the sector holds huge potential to attract FDI in its various segments. However, progress is possible only with the joint efforts of both the industry and the Government. On the one hand, the industry should work towards increased transparency, clear land titles, improved delivery and project execution while on the other hand the Government must provide fiscal incentives to developers to build low cost and affordable housing for the masses and also review the existing FDI guidelines for investment and development in Sudanese real estate in order to increase the flow of foreign capital into the sector.

The Government must provide more incentives to the public and private sectors to take up activities for new building materials and technologies so that the industry can deliver low cost, affordable, and sustainable and environment friendly housing and building structures.

The Sudanese real estate sector has traditionally been an unorganised sector but it is slowly evolving into a more organised one. The sector is embracing professional standards and transparency with open arms. Sudan has huge potential to attract large foreign investments into real estate. With real estate reaching a point of saturation in developed countries and the demand and prices falling, global real estate players are looking at emerging economies such as Sudan for tapping opportunities in real estate. Sudan real estate will stay attractive due to its strong economic fundamentals and demographic factors. Moreover, there is a high level of global uncertainty looming over the developed and developing nations of the world. While developed economies are still struggling to regain their growth momentum, developing countries including Sudan are expected to grow at a reasonably high rate. Investments in Sudan real estate will fetch higher returns for investors as compared to other global markets. In the coming years, the opportunities in the real estate sector will attract more global players to Sudan and hence will help the industry to mature, become more transparent, improve management and adopt advanced construction techniques.

Strong economic growth and increased investment in infrastructure are boosting the property investment market as a whole. Also the political stability of the country and increasing inward investment are creating a rich investment climate. All indications show that property in Sudan is now a highly beneficial market in which to invest.

## Chapter 11

# INFLOWS OF FOREIGN DIRECT INVESTMENT TO THE TELECOMMUNICATIONS SECTOR IN SUDAN

### 11.1 INTRODUCTION

It had been debated for a long time whether FDI is good or bad for the development of a country, particularly developing countries. Opponents of FDI argue that FDI, essentially, is a tool in the economic arsenal of developed industrialised countries in their overall strategy to control the resources and markets of developing countries. This control is necessary in order for Western corporations to counter the downward pressure that is continually exerted by shareholders on corporate profitability. Contrary to its claims, it is not a means to assist developing countries. However, FDI is well marketed by the West through development, literature and through institutions such as the IMF, the World Bank, the WTO, and even UNCTAD.

On the other hand, a more qualified proposition is made that properly regulated FDI can bring growth, jobs, technology, skills, market access and development; however its negative effects must be balanced with its good effects. FDI is neither good nor bad; it all depends on how you deal with it. This view is now becoming popular in many circles, including some reformed neo-liberal economists, especially after the East Asian and Argentinian crises of 1997- 2001.

Currently more than 90% of developing world government policies are dominated by the view that FDI is necessary for the development of their countries and, without FDI, there will be no growth. They also believe that FDI brings, *inter alia*, efficient management of resources, technology, a culture of competition, and access to global markets. FDI is the best source of development finance, on the grounds, among others, that it is self-liquidating, since foreign investors have to show profits for the host country as well as for themselves, and it does not lead to debt overhang. Obviously, Sudan is not an exception.

## 11.2 TELECOMMUNICATIONS SECTOR, GOVERNMENTAL POLICIES AND FDI INFLOWS

The Sudanese Government is working hard to attract large scale FDI into the country, including allowing foreign investors to hold unlimited equity and making concerted efforts to project a positive country image. The Government of Sudan has been striving hard in the last few years to cross the figure of US\$ 1 billion FDI into Sudan. To attract more FDI in country, the Government of Sudan opened many avenues for FDI and offered number of incentives to foreigners to invest in Sudan. The most important measure in this regard was that the government allowed 100% repatriation of profits by foreign investors, which is rare in other countries. The Minister of Investment visited many countries and had exclusive meetings with businessmen of those countries to convince them to invest in Sudan. It was also promoted to the world that the economy of Sudan was growing at faster pace which is a guarantee for the better return on investment.

The telecommunications sector of Sudan was one of the sectors which was opened for foreign investment by the Government of Sudan. This sector remained the talk of town over the last ten years when new, internationally renowned, players entered the telecommunications market of Sudan. Particularly in the cellular sector of Sudan, three new operators were added to the existing two cellular players who were already working in Sudan.

**Table 11.1: FDI in Telecommunications Sector (US\$ million)**

Year	Total FDI	FDI in telecoms	Telecoms share (%)
2006	3,534	1,835	51.1
2007	2,426	1,135	46.7
2008	2,601	1,179	45.3
2009	2,682	1,253	46.7
2010	4,293	2,345	51.1

Source: NTC Sudan

The huge flow of FDI into the Sudanese telecommunications sector illustrated in Table 11.1 is surely creating a positive impact on domestic economy. By regulating the FDI properly, the government can help achieve multiplier effects of this investment in the true sense.

Development in Sudan's telecommunications sector is one of the most visible achievements, together with oil, in Sudan. Total investment in the sector amounted to more than US\$ 6 billion. The growth in the sector is reflected in tele-density: 2% in 1995 rising to more than 70% in 2010. These two achievements have given the economy a great boost in spite of the fact that the benefits, from oil at least, have not reflected themselves yet in a visible way in the standard of living for the majority of the Sudanese people. The development in the telecommunications sector was very impressive, was able to attract considerable investments from outside the country and had enabled a good number of the population to be in daily contact with each other through the ingenious invention of the mobile phone. It brought distant people together in an unprecedented way at a time when the usually well-knit Sudanese social fabric was showing signs of decay, at least in Sudan's urban areas. About 17% of Sudan's population had mobile phones by the end of 2010, according to the Arab Advisory Group, Amman.

All this was a result of the privatisation policies which started in the mid-1990s in the telecommunications sector. It was started by the Sudan Telecommunications Company (Sudatel), whose paid up capital is at present no less than US\$ 725 million (about 70% paid by foreign investors); it is also the major company whose share is highly traded, 70% of total trading in the Khartoum Stock Exchange. Sudatel was able to attract foreign investors to establish a mobile company in the name of the Mobitel, now Zain, a Kuwaiti Group company.

The general policy of telecommunications affairs is run by the National Telecommunications Corporation (NTC), which is the sole licensing authority on behalf of the government. The government is intent on further liberalisation, allowing other mobile companies to come into Sudan, such as MTN from South Africa and Canar from the United Arab Emirates. The government, in its drive for more liberalisation and to attract more FDI to the country, decided to sell Mobitel after it

had reached about 1.7 million customers. It was wholly sold to a Kuwaiti investor for about US\$ 1.3 billion. Immediately after that, foreign investors started new mobile companies, Sudani and Canar Company. Numbers of mobile customers reached 26 million at the end of March 2010, with a growth rate of 5% from the last quarter of the year 2009.

### **11.3 SUBSCRIBERS OF TELECOMMUNICATIONS COMPANIES AND THE RANGE OF COVERAGE BY THE END OF YEARS 2009 – 2010**

The dynamic growth in the telecoms sector has been driven by investment that totals in the order of US\$3 billion up to 2007. Most of this sum has been invested over the period 2004 to 2007. However, the pace of investment is likely to slow down somewhat in the following three years with somewhere in the region of US\$ 700-900 million being invested up to 2010. The main urban area networks and links are now almost complete. All of this investment has been made against the backdrop of a trade embargo from the United States over the period being examined. It may sound obvious but it is worth saying that the more favourable the investment climate for new and existing operators, the more money will be invested in the country over the next five years.

Sudan is a large and growing market. Population size and above-average economic growth put Sudan in the top five markets African outside of North Africa and in the top ten markets if North Africa is included. Therefore the question is: how can market growth be encouraged so that its benefits can be experienced as quickly as possible by as wider number of people as possible. Currently the market is dominated by four players: Canar, MTN, Sudatel and Zain. The existing players possess the certainty of knowing that they hold fairly impregnable market positions, there are a number of underlying tensions in the market. A combination of limited access to international fibre links and the number and structure of international gateway licences means that international voice and data rates remain high.

Mobile telephony in Sudan has gone through a period of substantial development and change. The NTC reports (2009) highlight that the total economic benefit of the mobile industry to the Sudanese economy contributed US\$ 2.4 billion to the Sudanese economy, at the time 4% of GDP with a possible additional 1% in hidden impact.



Also the report draws attention to the fact that as well as providing over 40,000 jobs, the sector can claim to be responsible for a 0.12% growth in GDP for every 1% increase in market penetration (NTC, 2009). Given also that at the end of 2008, market penetration was still only at 28% or roughly 10 million customers, there is great potential for growth for the sector and for the benefit of the economy as a whole. It is worth noting that the penetration rate at the end of 2009 was 42% or 15 million customers. The mobile phone is also an important bridge to the Sudanese Diaspora worldwide with a highly significant, if not precisely calculable, contribution to GDP. Sudan began its telecom sector reform in 1993 but real developments happened only after the discovery of oil in 1997 which has helped spur growth and generate much needed foreign exchange. Sudan represents by the fastest growing fixed telephony market not only in Africa but worldwide. Telecommunication investment has skyrocketed from only US\$ 500,000 in 1994 to over US\$ 100 million per year (NTC, 2008).

**Table 11.2: Investment in the Telecommunication Sector**

<b>Operator</b>	<b>Up to 2007</b>	<b>Up to 2010</b>
Sudatel	US\$ 500 m	US\$ 200 m
Canar	US\$ 200 m	US\$ 100 m
MTN	US\$ 1 bn	US\$ 200 m
Zain	US\$ 1.5 bn	US\$ 300 m
Total	US\$ 3.0 bn	US\$ 800 m

*Source:* NTC Report

This massive level of investment has seen the number of jobs in the telecommunication sector more than double by 2006 and is likely to increase by just under a quarter over the period 2008 to the 2010, depending on the type of decisions that was made in relation to encouraging the growth of the sector.

The number employed in cyber-cafes has not been included as there is no reliable figure for the overall number of cafes of this kind. However, if included it might add a thousand or more Full Time Equivalent jobs.

**Table 11.3: Growth of Number of Employees in Telecommunication 2006-2010**

<b>Operator</b>	<b>2006</b>	<b>2008</b>	<b>2010</b>
Sudatel	3,000	2,000	2,000
Canar	250	400	550
MTN	100	700	1,400
Zain	300	1,100	1,500
Total	3,650	4,200	5,450

*Source:* NTC Report

Without far more detailed research, only the turnover of the major operators is available. Nevertheless, the turnover from these operators shows a steady growth of 30% + over the years 2006 to 2008 and growth of 20%+ over the two years 2008 to 2010. Although precise figure are not available for the turnover of internet and computing companies, they probably make up 5-10% of the employment in the overall telecommunication sector.

**Table 11.4: Operator's Growth in Turnover 2006-2008**

<b>Operator</b>	<b>2006</b>	<b>2008</b>	<b>2010</b>
Sudatel	US\$ 500 m	US\$ 400 m	US\$ 400 m
Canar	US\$ 34 m	US\$ 62 m	US\$ 186 m
MTN	US\$ 80 m	US\$ 200 m	US\$ 300 m
Zain	US\$ 150 m	US\$ 355 m	US\$ 400 m
Total	US\$ 764 m	US\$ 1,067 m	US\$ 1,286m

*Source:* NTC Report

The turnover shown above is matched by a similar amount of expenditure on things like wages, marketing and overheads. These expenditures are not lost to the economy but provide a 'multiplier effect' on the wider economy. On the basis of fairly conservative multiplier, this might be 1.5 times the level of initial expenditure, a figure of US\$ 1,929 million.

It was estimated by one operator that in 2007 all of the main operators together spent in excess of US\$ 55 million on marketing, with the lion's share being spent by MTN and Sudani. Predicting future growth in the sector depends a great deal upon the assumptions made about a number of variables including: the continuing existence of economic sanctions, growth in the overall economy and changes in the legal and regulatory framework. Only the latter is completely in the hands of Sudan's decision-makers.

There are two fixed operators in Sudan (Canar and Sudatel) and three mobile operators (MTN, Zain and Sudani, the mobile subsidiary of the Sudatel Group). Sudani is the only mobile CDMA operator, although Canar uses CDMA fixed wireless equipment as part of its offer. There are two international gateway licence operators (Canar and Sudani) offering access to other operators but the two mobile operators (MTN and Zain) have international gateways for their own use.

The mobile operators all use the infrastructure provided by Canar and Sudatel which includes significant fibre infrastructure and satellite coverage for rural areas. For example, Sudatel carries around 50% of Zain's overall traffic. All operators have effectively covered the capital and are moving to address a wide range of areas across the country, most notably connecting Southern Sudan to the rest of the country and putting in coverage along main highways. All operators are now focused on meeting the coverage requirements of their licences. By the end of 2008, Sudatel's network connected 205 towns and cities and Canar's connected 88 towns and cities. MTN has achieved between 38-40% coverage by population and Zain has achieved between 60-70% by the end of 2009. There is clearly a link between the reach of available microwave and fibre backbone and the overall cost of service to users.

As in many other countries in Africa, the number of fixed lines has gone down since the arrival of mobile phones. Three years ago there were 1.4 million fixed lines and now there are only around 200,000. Despite predictions over the last five years that fixed lines would grow, it seems more likely that this pattern of long-term decline will continue as mobile and fixed wireless coverage expands.

Sudatel was established in 1993 as a private company with the Government owning 67% and 33% of the company in private hands. It launched a mobile operation, Mobitel that was 60% owned by Celtel until it was bought out by Celtel's new owners, Zain. 4% of Sudatel was bought by UAE Company. Sudatel recently expanded its capital to US\$ 2.5 billion. The new company inherited a network that had gone through a fairly long period of under-investment and its first priority was to rehabilitate and improve the telephone exchanges in Khartoum State. From that early point, it has gone on to develop a national and international fibre network, a DSL service, a fixed wireless service and a CDMA mobile service.

**Table 11.5: Subscribers of Telecommunications Companies and Range of Coverage at End of Years 2009–2010**

<b>Company</b>	<b>Subscribers 2009</b>	<b>Subscribers 2010</b>	<b>Change (%)</b>	<b>Covered Areas 2010</b>
Sudatel Company	3,140,794	4,605,911	46.6	1,078
Thabit Company	66,112	237,064	258.6	N.A
Sudani Company	3,074,682	4,368,847	42.1	1,078
MTN Company	3,772,556	3,474,879	-7.9	1,409
Zain Company	8,492,657	10,249,505	20.7	905
Canar Company	297,251	307,620	3.5	151

*Source:* NTC

Table 11.5 outlines the major players in the telecommunications sector.

The number of subscribers for Sudatel increased noticeably from 3,140,794 in 2009 to 4,605,911 in 2010, a growth of 46.6%. In addition, the growth in fixed lines for Thabit

was 258.6%, and 42.1% for mobile phone services for Sudani. For MTN, the number of subscribers decreased from 3,772,556 in 2009 to 3,474,879 in 2010, due to reclassification of clients. For Zain, the number of subscribers increased from 8,492,657 in 2009 to 10,249,505 in 2010, by 20.7%. For Canar, the number of subscribers increased from 297,251 in 2009 to 307,620 in 2010, by 3.5%.

### **11.3.1 Zain Group**

Zain Group is a mobile telecommunications company founded in 1983 in Kuwait as MTC (for mobile telecommunications company), and later rebranded as Zain in 2007. Zain has a commercial presence in eight countries across Africa and the Middle East, with about 37.6 million customers as of 31 March 2010. It employs 60,000 people. From 2005 to 2010, Zain maintained a presence in a number of countries in Sub-Saharan Africa, in addition to its core market in the Middle East region.

Zain entered Africa in May 2005 through the US\$ 3.4 billion purchase of Celtel International which had 13 countries in Africa, serving five million customers at that time. Zain invested heavily across the continent in network upgrades and acquiring two more country licences. In 2006, Zain acquired the remaining 61% stake of Mobitel, Sudan's first mobile operator, in a deal valued at US\$ 1.332 billion, resulting in 100% ownership. By June 2010, Zain had over 40 million customers across the continent. The company renewed its license in Sudan for a period of 20 years.

Zain's value chain contributes to broad economic development across the areas of operation in Sudan. The most direct economic benefit that Zain provides is the creation of jobs for local nationals. All of its management teams are primarily composed of Sudanese people, and Zain employs thousands of people directly to work in various jobs, and supports many more jobs indirectly. Franchises and distributors have been established to reach customers to sell Zain's products and approach.

Zain empower which has empowered people to become entrepreneurs with their own business. Zain also works with a variety of contractors who support the expansion and maintenance of its telecommunication network. Zain currently has 48 distributors and 30,628 outlets in Sudan (Zain Annual Report 2012).

One of the biggest economic impacts of Zain is helping to connect people with the world around them. Economic activity is increasingly conducted online and access to internet and mobile services is an essential component for people in order to increase economic opportunities. The expansion of mobile financial service offerings is also contributing to economic development.

### **11.3.2 MTN Company**

Launched in 1994, the MTN Group is a multinational telecommunications group, with its core operations in 21 countries in Africa and the Middle East. As at the end of 2008, MTN had recorded more than 9,070,000 subscribers. MTN launched in Sudan in 2005. The company won the second GSM license in 2004 (NTC, 2011).

### **11.3.3 Canar Company**

Canar Telecommunications Company established its presence in Sudan in 2005. Canar provides communications services. Its products and services include voice, data, internet services for home and business, and multimedia services. The company also provides mobile satellites in Asia, Africa, Europe and the Middle East. In addition, it provides local and long distance leased lines, managed network services for corporations whose operations are spread across urban areas across Sudan.

## **11.4 POLICIES AND REGULATIONS IN THE TELECOMMUNICATION SECTOR**

The telecommunication sector in Sudan is the fastest growing economic sector. The total investment in the sector has amounted to more than six billion dollars. The growth in the sector is reflected in tele-density increasing from 2% in 1995 to more than 70% in 2012. There has been a steady increase in the number of mobile subscribers as well as in revenue since 2003. Mobile customers reached 25 million by the end of March 2012 with a growth of 5% from the previous year, and internet users are currently estimated at eleven million. However, registered broadband users have just exceeded one million.

Revenue growth was 9.8%, while subscriber growth was 17.6%, which indicates clearly that new subscribers have not added the same revenue as previous subscribers considering that there was no or very small change in tariff.

The behaviour of the customers is developing along with this growth and the new technology in the telecommunications sector: the researcher found that there is a change in traffic type, voice traffic is declining and data traffic is increasing. Traffic shows a decoupling phenomenon between traffic and revenue. Due to the flat rate tariffs offered by the operating companies, the cost is no longer matching the revenue for delivering an ever-increasing amount of data over the same network.

Privatisation policies succeeded in attracting four operating companies, three delivering mobile services and two managing the main backbone network for the country and delivering fixed network services. Geographical coverage of the services is estimated not to exceed 69% of the total inhabited land area in Sudan, while population coverage has exceeded 85%.

The telecommunication sector in Sudan has a chain reaction effect on other economic sectors. The empirical survey study showed the effect of telecommunication services on major aspects of the economy, such as economic growth, productivity, and job creation. The development in the telecommunication sector leads to a proportional increase in percentage of the GDP, because telecommunications services form a key component of the development of other industries in the matrix of social and economic development, such as manufacturing industries, banking and finance services. Telecommunications services do not refer only to infrastructure and hardware but also to data, information and knowledge and the associated human resource skills that are required to drive and manage these.

The effect of telecommunication services is not the same in all parts of the world. In developing countries, for example mobile payment has boomed, as limited payment methods and tools are available and the majority of the people are unbanked. In Japan, animated pictures and location based-services over mobile are widely used. Mobile services developments are related to the local environment and conditions for each country.

The National Telecommunication Corporation works to regulate the telecommunication sector in Sudan. Its role with regard to the internet is to increase the reach and coverage of broadband services, to encourage the adoption of broadband, and stimulate the demand for broadband usage. However, broadband spread can only be realised if there are attractive content and services to consumers are provided. The spectrum of consumers includes businesses, public sector organisations, as well as individuals.

Governments and the regulatory authorities have an active role to play in stimulating demand. Regulatory authorities should sponsor national projects in key development areas to increase the demand stimulation. These projects can be financed through the universal service fund to provide solutions in key development areas: community medicine to improve healthcare; agriculture information and monitoring system; and education improvements. Regulation needs two types of reform: the first is a hybrid regulatory approach and the second is to encourage investment in developing content. Hybrid regulation refers to the involvement of more than one regulatory authority in one entity to regulate new services.

Telecommunication services providers have more roles to play in the capital market in Sudan. Operating companies will need to become content providers rather than just carriers providing communication channels. Mobile payment services have not flourished in developed countries, nor are the weather forecast for a specific area received through SMS on a mobile needed by farmers in developed countries. In developing countries the role of the telecommunication service providers is to sensitise other players in the market to develop content services in relevant areas, e.g., health, learning and agriculture news and assistance to farmers. The impact on the economy will exceed all expectations, provided the services are directed towards the key areas for development.

Government policies and regulations have been recognised as an important tool to steer the sector and drive it to achieve its goals. The most important factor that has led to stunning success in the telecommunication sector was the free market combined with government regulation. These actions opened the door to competition and lower prices. The utilisation of broadband access and the extension of fibre to reach home or



office should be directed to provide services in key areas for development such as health, education, agriculture, and the creation of jobs. The financial sector should be encouraged to invest in areas related to the telecommunication sector, especially in content development, and in key development areas innovative ideas should be sought to assist and accelerate development.

## **11.5 THE IMPACT OF MOBILE COMMUNICATIONS ON SOCIO-ECONOMIC CONDITIONS IN SUDAN**

In this section of the chapter, the researcher highlights the socio-economic impact of mobile telephony in Sudan. It reveals how mobile communications in Sudan are creating jobs, generating wealth and saving lives. The social and economic impact of mobile communications in Sudan, and the contribution of Zain will be discussed, as it is the biggest operator in Sudan with a customer market share of 60%.

Firstly, the researcher examines the social and anthropological factors affecting how people have traditionally communicated in Sudan and how it happens today. The economic impact of mobile communications in Sudan, a financial analysis of the economic factors, considering both supply and demand side effects, and the impact of telecommunications on growth will be discussed.

Mobile telephony in Sudan has gone through a period of substantial development and change. A report from Zain highlights that, in 2008, the total economic benefit of the mobile industry to the Sudanese economy contributed US\$ 2.4 billion to the Sudanese economy, at the time, 4% of GDP, with a possible additional 1% in hidden impact.

In addition, the report draws attention to the fact that, as well as providing over 40,000 jobs, the sector can claim to be responsible for a 0.12% growth in GDP for every 1% increase in market penetration. Given also that, at the end of 2008, market penetration was still only at 28%, or roughly 10 million customers, there is great potential for growth in the sector and for the benefit of the Sudanese economy as a whole. It is worth noting that the penetration rate at the end of 2009 exceeded 42% or 15 million customers. The mobile phone is also an important bridge to the Sudanese diaspora worldwide with a highly significant, if not precisely calculable, contribution to GDP.

According to Ericsson's Vice-President, mobile communications have been proven to help in the development and prosperity of societies, especially in developing countries. As part of commitment of Zain to making communications more affordable and accessible for all, Zain undertook this study to quantify the key economic and social impacts that mobile communications are having on the Sudanese society, one of Africa's fastest growing mobile markets. The study finds that mobile communications is greatly aiding the micro-economic activities of traders and entrepreneurs in Sudan, as well as helping families remain in contact across the rural-urban divide of the country.

From direct interviews with key personnel in Zain, the researcher finds that mobile telephony has not only created direct employment within the telecommunications sector itself, but has also had a major impact on Sudanese agriculture, the nation's largest industry, not least by providing valuable weather updates and warnings, by supporting a mobile marketplace which links produce buyers to sellers, by providing up- to-date market pricing, and by supporting auctions and bidding.

At a social level, as networks extend beyond the Khartoum region to include South Sudan and even conflict-ridden Darfur, mobile telephony has also allowed families to stay in contact in time of conflict, migration, and large population displacements. It has also been invaluable in supporting health, education and family, especially in the refugee camps.

The scale of mobile sector investment within total foreign investment is substantial. According to official reports, Zain estimates that, in 2008, mobile network operators invested over US\$ 108 million in new capital equipment, while foreign ownership of the fixed operators has also driven further inward investment especially into mobile network technology.

The findings also drew praise from the Director of the Earth Institute, and Special Advisor to United Nations Secretary-General Ban Ki-moon, 'The report underscores the central fact that mobile telephony offers a remarkable, indeed unique, tool for economic development, and can even reach the poorest of the poor through creative approaches by the providers and users.' The report has described mobile telephony as 'the single most transformative technology development' of recent times.

## **11.6 CONCLUSION**

The liberalisation and privatisation of the telecommunications sector, the governmental policies, the regulations and plans adopted by the Government of Sudan have created a capital-attracting, pro-competitive policy environment that has fostered the build-up of a modern, fully digital infrastructure in the country and furnished a climate suited to enhance development nationwide.

The remarkable transformation and achievements witnessed in the Sudanese telecommunications sector, coupled with the growing and diversifying use of the Information and Communications Technology services, including those of the internet and its applications, have been a very significant success that has made Sudan perceived as the most developed in Africa, if not in the Middle East. But the telecommunications market is still considered to be virgin; huge investment opportunities exist and shall probably explode with the full realisation of peace and stability throughout the country. The telecommunications sector currently has an annual growth of 70% making it the fastest growing in the world (National Telecom Corp. Report 2010).

## **Chapter 12**

### **CONCLUSION AND RECOMMENDATIONS**

#### **12.1 INTRODUCTION**

This chapter provides a summary of the thesis, which presents outcomes of the thesis. This chapter summarises the thesis, discusses the benefits of the research, the difficulties encountered and what improvements that can be done to the research. The suggestions for future work also discussed as well as policy recommendations.

As mentioned in the introduction and the methodological chapter, the research is attempted to explore the impact of policies followed by the host country on the amount of inward FDI and the impact of FDI on the economic development of the host country. In conducting this research, combinations of qualitative and quantitative methods have been employed. A case study approach has been adopted to investigate the impact of the measures taken by the government of Sudan to encourage FDI. As well as investigating the impact at the macroeconomic level, the study focuses on the three sectors most affected by FDI: oil, real estate and telecommunications.

This chapter reviews the findings and discussed the main findings from the analysis which were conducted in this thesis. It presents a combination of the results emerging from the analysis of the data collected, business survey and interviews. As this research employed a combination of qualitative and quantitative methods in collecting and analysing the data, it has produced various findings in responding to the objective of the study.

This research has involved in depth investigation of the possibility that the trade policy regime followed by the host country significantly influences both the amount of inward FDI received by the host country and a detailed analysis of the impact of FDI on Sudan's economic growth. This chapter aims at bringing all the findings of the study with the objective of developing a better understanding in systematic and integrated manners.

## **12.2 SUMMARY OF THE RESEARCH**

In the discussion of the literature review, an attempt was made to answer the question as to why developing countries are increasingly looking for best practice policies regarding FDI. The present study attempts to explore the theoretical foundation of the FDI phenomenon and its relevance in explaining FDI determinants and behavioural patterns. The results indicate that FDI is considered an important tool of technology transfer, and also contributes greatly in economic growth, and policies implemented by governments in developing countries are dominated by the view that FDI is necessary for development and that, without FDI, there would be no growth.

This investigation, although taking Sudan as a detailed case study, may provide some development implications for the FDI in developing countries as a whole. According to the World Investment Report 2009 (UNCTAD, 2009), the number of policy measures adopted by several developing countries continued to make the business environment more conducive to FDI. Sudan's case is consistent with this observation. The case of Sudan may also have implications for other developing countries, as this is a typical case of South-South FDI. Despite some positive effects of the FDI on Sudan's economy, it is important to emphasise the contextual nature of the impacts observed and the limitations of the information available.

The drying up of grants and technical assistance greatly affected many projects earmarked for the rural people of Sudan. With these constraints, Sudan found no alternative except to take strict measures to drive towards some friendly nations in order to encourage foreign investments.

With regards to Chapter 7, evidence from data collected shows that the economic liberalisation policies for economic restructuring, attention to the infrastructure, privatisation, the establishment of the capital market and other measures assisted in opening Sudan's doors.

Governmental policies had encouraged the implementation of a number of macroeconomic reforms; signs of prosperity pervaded the community and encouraged considerable foreign investment to enter the Sudanese market.

Consequently, prices have been liberalised, and import/export restrictions have been abolished. Moreover, a more liberal law encouraging investment has been promulgated, an extensive privatisation and restructuring programme for public enterprises has been implemented, and the multiple and overvalued exchange rate has been replaced by a floating rate. In its endeavour to liberalise trade, the Government has taken numerous measures including the removal of quantitative restrictions on imports, and the simplification of tariff procedures and structures.

As shown in Chapter 6 as result of reforms implemented, the real GDP increased by 9.4% for the year 1995. In 1999, GDP increased by 3.4% and, in 2000, by 4.7%. According to the World Bank report updated in April 2009, the GDP for the year 2002 was US\$ 13.5 billion.

These policies, which were meant to influence demand and activate the supply side, attracted the attention of the IMF, and therefore relations with Bretton Woods institutions improved. Sudan's progress from 1997 to 2009 with the IMF Staff Monitored Program was one of the important factors that contributed to Sudan's reinstated voting rights at the IMF in 2000.

As shown in Chapter 8 Sudan has implemented economic policies that aim to maintain economic stability and foster growth. Sudan is committed to maintaining macroeconomic stability and advancing the reform agenda, especially in fiscal and financial reform, to tally with the IMF measures. This will be through a process of economic integration under the support of international multinational instruction and development partners. Sudan's government has endeavoured to maintain its focus on enabling high levels of growth with low inflation, benefiting from the substantial increase in oil production.

A number of important structural reforms were completed in 2007 as a reflection of this. In 2008, the budget facilitated a notable improvement expressed by steps made with respect. In renewing tax exemptions and improving tax administration the most outstanding examples are: (1) the investment encouragement act has been amended to halt the granting of new task-law; and (2) restoring confidence in public financial management is a central objective of 2008 fiscal policy. Given the difficulties that have emerged in the past from a mismatch between expenditure commitment and

available resources, the government adheres strictly to the fiscal stance outlined in the 2008 budget.

The Law determines that guarantees may be given to investment projects which contain promises not to nationalise or confiscate any project except by a specific law, and with fair compensation. The Law also guarantees not to distress the project or confiscate the money of the project except by judicial rights. The Law allows the investor to return the money in the case of difficulties facing the implementation or wind-up of the project; also, the investor may re-export the machineries and equipment, vehicles and other tools exported for the project. The Law allows transferring projects and cost of financing or loans by foreign currency after paying the project obligations. The Law also allows import of raw materials and export of products after the project is entered into exporters and importers registration.

It can be seen that the economic liberalisation policies, economic restructuring, attention to the infrastructure, privatisation, and the establishment of the capital market and other measures assisted in opening Sudan's doors. All these policies encouraged a number of investors to take Sudan seriously and decide to invest in Sudan. Chapter 8 findings are supported by the responses given during interviews; most interviewees believe that the measures assisted in attracting foreign investors.

The empirical analysis show that, the flow of foreign capital to Sudan, by foreign investors or by partnership with the host countries, directly contributed to making tangible changes in the economic position of the country.

The flows of FDI took on a serious and sizeable level gradually after the adoption of the liberalisation policies which, together with removal of subsidies, cancellation of administrative pricing policy, and devaluation, largely opened the economy and encouraged investors to enter Sudan.

Foreign investors find that Sudan's economic prospects are promising: the country has a considerable natural resource base. Economic growth is between 8-10% a year until 2010. This reflects the impact of the ongoing investment boom, the discovery and exploitation of oil, and the stabilising impact of the Comprehensive Peace Agreement, among other things.

Findings from Chapter 9 show that oil revenues have created a building boom in the capital and attracted FDI to other sectors in Sudan, and hence government focused much of its effort on this sector, which dominated by Chinese companies. Many of these issues faced were similar to those experienced elsewhere in Africa where China is the source of FDI.

As discussed in Chapter 8 and Chapter 9, we find that the various positive impacts of Chinese investment in Sudan and the opportunities for enhancing development in Sudan's economy include: the impacts of oil in satisfying domestic consumption and achievement of self-sufficiency; increasing government and public revenues; rapid and impressive economic growth as measured by the growth in GDP and its composition and structure; increasing FDI, and the increase in the volume of foreign trade, as measured by the volume and structure of exports.

Evidence in Chapter 10 from the field survey shows that the inflows to the real estate sector were mainly from the Gulf, with developers seeking to build residential accommodation and commercial property, which would appeal to Sudanese expatriates. Qatar, United Arab Emirates and Kuwait have the largest real estate projects in Sudan.

Chapter 11 shows that telecommunication sector as well has benefited from FDI. There are four main operators: Canartel from United Arab Emirates, Zain of Kuwait which is the largest service provider, MTN from South Africa and Sudatel which is a public company quoted on the Dubai and Khartoum stock exchanges. The government still has 18% of Sudatel, but is likely to sell this. Telecommunications, in particular mobile services, have brought a social revolution in Sudan, as well as elsewhere in Africa, and it has a chain reaction effect on other economic sectors. The researcher found that the effect of telecommunications was seen in all aspects of the economy, such as economic growth, productivity, and job creation. Development in the telecommunication sector leads to a proportional increase in percentage of the GDP. The government's aim was to open the market up, with competition making phone tariffs more affordable.

The sectors to benefit most from the FDI inflows were telecommunications, oil production and real estate. FDI in Sudan's oil industry brought the direct effect of



large revenues and the indirect effect of industrial linkages. The subsequent re-investment of the oil revenue by the Government of Sudan and diversification of foreign investment in non-oil sectors led to other industries taking off, and the emergence of domestic investment and local entrepreneurs. The huge flow of FDI into Sudan's telecommunications sector surely created a positive impact on domestic economic growth; the growth in the telecommunications sector was more than 70% in 2010. Also, FDI plays an active role in the real estate and construction sectors, which have an important contribution to the GDP in Sudan.

Overall, government policies to encourage FDI have been successful, but it is evident that different policies are needed for each sector.

### **12.3 POLICY RECOMMENDATIONS**

Sudan's policies and institutions for FDI promotion have come a long way from the Approved Enterprise Concessions Act in 1956, with its vague definition of FDI and diversified implementing authorities, to a full-fledged Ministry with a mandate to determine the viability of the incoming FDI projects in the light of the national priorities. The ministry of investment is a subscriber to the World Bank's Multilateral Investment Guarantee Agency, and the International Center for the Settlement of Investment Disputes.

However, policies for FDI promotion need to acknowledge that Sudan is at an early stage of its investment development path and faces the challenge of transformation to fit into the current global division of labour. Recently the world market witnessed a rise in the share of trade in intermediate goods characterising a shift in comparative advantage from natural-resource-intensive towards manufacturing, service and knowledge intensive industries. The attraction and motivation of manufacturing FDI with substantial spillovers require significant up-front expenditures on human capital and infrastructure before the domestication of any of these positive externalities takes place.

A large number of Chinese private investors were attracted in the manufacturing sector. These small size firms have great potential for creating capacity in import-substituting industries, value addition and employment. Hence, rather than gearing the

incentive structure towards the eye-catching big incoming firms, the Ministry of Investment needs to develop a more simplified licensing procedures to attract these firms, especially in joint ventures with the Sudanese private sector in order to diversify away from the politically loaded dealings with China. The Chinese private firms can fit in the easy stage of import-substituting industrialisation currently characterising the Sudanese economy, and can adapt their production to a large number of low income consumers.

Recently, eight protocols were signed between Sudan and China for cooperation in the agricultural sector, including setting up a pilot agricultural technology demonstration centre in Sudan, along with a memorandum of understanding on the migrations procedures of Chinese workers in Sudan. Although developing agriculture and imparting agrarian technology and skills is important, such a package needs to be bundled with more market access for Sudan semi-processed traditional agricultural products, and infrastructure for linking producers to local markets.

It is arguable that Sudan was pushed by sanctions since 1996 and later on by the pressures of the international civil societies to direct itself towards the countries of South East Asia instead of Western European countries or the US. Obviously, diversification of the sources of FDI and technology is important. Still, Sudan obtains some critical technological and components through products third market with high costs. Hence Sudan needs to study carefully its agreements and protocols with China to ensure maximum benefits from these deals, which are backed up by its oil. The government needs to be strengthened and linked to other specialised national institutions to effectively monitor and supervised the implementation of the key investment projects, irrespective of who is investing, and to ensure their viability and continuity.

Beyond bilateral deals, Sudan can benefit to great extent from coordination with the regional economies, for the simple reason that, the world is networked and is not flat. Cooperation remains essential for coordinating developmental complementarities. Infrastructure, food security and health are examples of activities with great trans-boundary benefits of complementarities, and are areas for developing and strengthening multilateral dialogue beyond the principle of bilateralism. Obviously

coordinating trans-boundary infrastructural projects to enhance the accessibility of these countries is of critical importance, China's official stance and announced commitments towards its engagement in Africa emphasise the promotion of multilateral dialogue mechanisms. The mediation efforts of China on Darfur were coordinated through the African Union and the Forum for China African Cooperation.

## **12.4 PROPOSITIONS FOR FUTURE RESEARCH**

Rapid and sustained economic growth is only the first step towards development. FDI appears to have played a role in Sudan's development but it remains insufficient, with its benefits heavily dependent on continued appropriate co-evolution of TNCs and host institution strategy.

Further research is needed for a better understanding of the development implications in Sudan, especially of the government's plans for education, health, non-oil sectors such as agriculture, oil income distribution, and for the institutional environment including tax and other FDI policies. Recent events also necessitate an examination of the impact of global financial liquidity constraints and the rapid oil price decline since mid-2008, even though the current crisis only partly contributes to the reduced oil revenue and FDI in Sudan. The country's peace was achieved largely because the government agreed to share the oil revenue with the south. The negative impact on FDI and the entire economy arising from the potential instability at the time of Sudan's 2010 presidential election indicates that stability is of paramount importance to Sudan's development. Above all, this is a necessity to improve both the FDI strategy and the country's capacity and institutional environment so that Sudan could not only attract FDI but also maximise the benefit of FDI.

The following propositions are therefore considered important for further research:

P1: Sudan's development will be adversely affected by the impact of global financial liquidity constraints and the rapid oil price decline.

P2: Sudan's development will take off as long as the country successfully channels oil profits to the manufacturing and service sectors, and ensures the continuing growth of these sectors.

P3: Sudan's development will take off as long as FDI has produced sufficient linkage and spill-over effects, while local human capital is ready to make use of the opportunities.

P4: Sudan's development will take off as long as the peace can be kept and the Darfur issue can be resolved.

P5: Sudan's development will take off as long as FDI works hand in hand with host institutions.

This investigation, although taking Sudan as a detailed case study, may provide some development implications for the FDI in developing countries as a whole. According to the World Investment Report 2009 (UNCTAD, 2009), the number of policy measures adopted by several developing countries continued to make the business environment more conducive to FDI. Sudan's case is consistent with this observation. The case of Sudan may also have implications for other developing countries, as this is a typical case of South-South FDI. Despite some positive effects of the FDI on Sudan's economy, it is important to emphasise the contextual nature of the impacts observed and the limitations of the information available.

At the same time, the commercial and social impact of Chinese TNCs and their role in shaping more inclusive local policies stand in contrast to the generally negative portrayal of China's political involvement in Sudan. There are identifiable links between Chinese-led oil development and the move towards resolving the internal conflicts.

FDI can make positive contributions to development, particularly in developing countries, due not only to its capacity appropriate for developing countries, but also to its strategies and mindset being more adaptable to the development needs and institutional environment in the host country. While current researches often emphasise how institutions make FDI's impact on host country differ (Boudier-Bensebaa, 2008) and how institutions in developing countries should be improved in order to attract FDI, this research indicates that TNCs' proactive adaptation of strategy to fit local needs and institutions may be more effective for improving institutions and consequently the development in host countries.

## **12.5 EPILOGUE**

This study has been aimed at exploring and analysing the impact of policies followed by the host country on the amount of inward FDI and the impact of FDI on the economic development of the host country in doing so, quantitative and qualitative methods, and primary and secondary data were utilised. A case study approach has been adopted to investigate the impact of the measures taken by the government of Sudan to encourage FDI as well as investigating the impact of these policies on Sudan's economic growth. The empirical analysis have provided valuable results and indicated that government policies to encourage FDI have been successful but it is evident that different policies are needed for each sector. Thus, this study has fulfilled its aims and objectives; and hence is now completed.

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## **Appendix 1: Academic Questionnaire on FDI in Sudan**

### Information for Participants

I'm a PhD student at Durham University, United Kingdom. I'm conducting this survey as a part of my research. It will be very helpful if you can give your valuable insights on this questionnaire. In this respect I would like to confirm that all answers will be held strictly confidential and anonymous and your contact information will not be copied to any other party.

Thank you in advance for your cooperation and for your participation in the research.

The title of the research is: The impact of government policies in developing countries: Sudan case study. It is about how the government attract the foreign direct investment and the big firms in the other country to come and invest in specific or industry and how they put the regulations to attract them.

The people who will be asked are the investors who already start a business in the country, and key personnel in the government.

All questions are related to the field of the foreign investors business and about the policies and regulations that control the investment environment.

The outputs will help to understand how the government developed a specific sector by policies to attract foreign investment, the information will help researcher to complete his research.



## **Foreign Direct Investment in Sudan**

**All question related to FDI in Sudan.**

### **Contact Details:**

**Name:** .....

**Job description:** .....

**Company name:** .....

**Company nationality:** .....

### **Professional address (optional)**

.....  
.....  
.....  
.....

### **Survey Questions**

#### **Description of the project:**

- ☐ Shared between foreign investor and Government.
- ☐ Shared between foreign investor and Sudanese private sector
- ☐ Foreign Investor only.
- ☐ Other.

#### **Findings for the impact of FDI on the GDP**

- ☐ Sector of investment:
- ☐ Industrial
- ☐ Mining
- ☐ Other

**Type of Management:**

- ☐ By foreign investor ☐ By Sudanese
- ☐ Both Foreign investor and Sudanese
- ☐ Other

**Are these following facts influence your investment decision to Sudan?**

- ☐ Political stability ☐ Tax incentives
- ☐ Transfer of project profit abroad.
- ☐ Project registration and government approval.
- ☐ Local shareholder. ☐ Infrastructure.
- ☐ Exchange rate. ☐ Clearness of government policies.

**How long have you been investing in Sudan?**

- ☐ 1.5 years ☐ 2.6-10 years
- ☐ 3.11-15 years ☐ 4.16-20 years.

**Based on your experience, what do you think about investment in Sudan?**

- ☐ Very good ☐ Good
- ☐ Average ☐ Bad

**Have you encountered any obstacles while you doing your investment in Sudan?**

- ☐ Tax: High rates of tax or complex rules.
- ☐ Testing certification or approval procedures.
- ☐ Security issues
- ☐ Health and safety regulations.

**Which area of the country sector do you think offer huge opportunity for your business?**

☐ Agriculture ☐ Property investment/real estate

☐ Communication ☐ Oil / Gas petrochemical

**Would you consider having joint venture with a Sudanese local firm?**

☐ Yes ☐ No ☐ Not sure

**How far do you agree with this statement “Sudanese government organize trade delegations, conferences and exhibitions in order to encourage foreign investors to do business in Sudan”**

☐ Strongly agree ☐ Agree

☐ Neither agree or disagree ☐ Disagree

**In your opinion, what are currently the main obstacles for your business to penetrate to the Sudanese market?**

☐ Restrictive regulations ☐ Exchange rate

☐ Security issues ☐ Lack of government support.

**Have you encountered any obstacles while you employing workers for your investment in Sudan?**

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.....

**Any comment related to investment in Sudan?**

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## **Appendix 2: Request for Interview**

15 November 2009

To Whom It May Concern

Request for interview on the subject of foreign direct investment in Sudan,(PhD research purpose).

I'm a PhD student at the University of Durham. My PhD research is on the Impact of the government policies. I'm based at Durham University doing my field work at Sudan from 21 Dec to 15 Jan. My field work involves interviewing decision makers, foreign investors and academicians towards their opinion on the foreign direct investment in Sudan, and the government policies to attract foreign inflows.

I appreciate your fully busy schedule but an opportunity to interview you at any time during my field work (until) would be great benefit to my research.

The purpose of the interview would be exclusively for academic purpose and to enable me to have a better understanding on FDI. Should you have no problem with my request, I would appreciate if you give suitable time and exact date for the interview session.

However, if you wish to answer the interview questions through email, I attach here the list of interview questions and you may answer the questions accordingly.

I appreciate your cooperation in answering all the questions and reply to my email at mohmdnour@hotmail.co.uk.

I prefer to meet you to conduct this survey and I am looking forward to get your personal response to the questions as well as your general views to the issues.

Looking forward to hearing from you.

Yours sincerely

Mohamed Abdalla

PhD researcher

Durham University

## **Interview Questions**

**All question related to FDI in Sudan.**

**Contact Details:**

**Name:** .....

**Job description:** .....

**Company name:** .....

**Company nationality:** .....

**Professional address (optional)**

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.....  
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**Questions for Foreign Investor:**

1. Why you choose to invest in Sudan?
2. What kind of policy taken by the Sudan's government attract you most?
3. Is the infrastructure well developed to start an investment in the field you choose?  
And how it affects the investment?
4. What kind of change should the Government of Sudan do develop the investment policies?
5. How the tax systems affect your investment? And what fiscal incentives the government offers to you?
6. What make Sudan differ from other countries in the same region to start an investment in it?
7. What is effect of the Sudanese income levels to your investment in paying the salaries?
8. What kind of advantage your firm found in Sudan?

9. Is there any protectionism for the local investors? If yes how these policies affect your business?
10. What was the size of your investment in million USD?
12. What are the main obstacles of investment in Sudan?
13. What are the contributions of the Chinese FDI to Sudan?
14. What are the important factors, apart from natural resources, that attract foreign investors to Sudan?
15. What policies would you suggest for the government of Sudan to implement to attract FDI?

### Appendix 3: Population and Participants in Questionnaire and Interview on FDI in Sudan

Description of Population and Participants		
	Descriptions of Interviewed Person	Descriptions of Organization
1.	Key personnel, senior staff and managers of relevant department working for foreign and joint-foreign companies investing in Sudan.	Companies interviewed were investing in different sectors: Oil, Real estate and constructions, Telecommunication, Agricultural, Industry and Trade.
2.	Officials and Key personnel working for the government in relevant ministries.	Ministry of Investment, Ministry of Foreign Trade, Ministry of Energy and Mining, Central Bank of Sudan, International Trade Centre and Ministry of Justice.
Numbers of Participants		
1.	Number of selected companies listed in the Ministry of Investment in Sudan and were identified as having established a business in Sudan,	1,197
2.	Number of selected companies for the questionnaire survey.	375
	Number of responses received	155
3.	Direct meetings followed the questionnaire.	45
4.	Total of respondents for questionnaire.	200
5.	Interview with key personnel in the private and public sectors	73